

LAW 463A: SECURITIES REGULATION  
CHRISTIE FORD  
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BY

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Note: The materials here may not be in the same order as in the syllabus, but are arranged in the way that makes sense to me. I'm sure that you can work this out.

CAPITAL MARKETS	8
TYPES OF SECURITIES	10
DEBT FINANCE	
EQUITY FINANCE	
SECURITIES REGULATION	13
GOALS OF REGULATION	
TYPES OF REGULATION	
SOURCES OF REGULATION	15
CONSTITUTIONAL DIVISION OF POWERS AND HISTORY OF REGULATION	
<b>R. v. W. MCKENZIE SECURITIES LTD. [1966] MBCA</b>	
Inception of inter-provincial securities regulation	
BCSA PART 19.1: INTERJURISDICTIONAL COOPERATION	
<i>167.2 Delegation and acceptance of authority</i>	
<i>167.3 Subdelegation</i>	
<i>167.4 Revocation</i>	
<i>167.5 Adoption or incorporation of extraprovincial securities laws</i>	
<i>167.6 Exercise of discretion, interprovincial reliance</i>	
<i>167.7 Review of Extraprovincial Decision</i>	
<i>167.8 Appeal of Decision of an Extraprovincial Securities Commission</i>	
<i>167.9 Appeal of Determination of Commission</i>	
<b>MULTIPLE ACCESS V. MCCUTCHEON [1982] SCC</b>	
Provincial Securities Acts are not ultra vires, as long as they co-exists with federal corporate statutes.	
SOURCES OF PROVINCIAL REGULATION	
SELF-REGULATORY ORGANIZATIONS	
<i>24 Recognition</i>	
<i>26 Duty to regulate, conduct and provide information</i>	
<i>27 Powers of the commission</i>	
<i>30 Records of transactions</i>	
PUBLIC OFFERING	21
PROSPECTUS	22
PROSPECTUS REQUIREMENTS	
<i>61 Prospectus required</i>	
<b>S.E.C. v. C.M. JOINER LEASING CORPORATION [1943] US SC</b>	
The reach of securities regulation extends beyond the statutory definition of security.	
<b>S.E.C. v. W.J. HOWEY CO. [1946] US SC</b>	
Establishes the Common Enterprise Test definition to and Investment Contract	
<b>STATE OF HAWAII V. HAWAII MARKET CENTER INC. [1971] HWI SC</b>	
Established the Risk Capital Test definition to Investment Contract	
<b>PACIFIC COAST COIN EXCHANGE V. ONSECCOM [1977] SCC</b>	
Canada accepts US tests as stated in Howey, Hawaii and Joiner Leasing	
BCSA PART 9 PROSPECTUS REQUIREMENTS	
<i>62 Voluntary filing of prospectus</i>	
<i>63 Contents of prospectus</i>	
<i>64 Executive director's discretion</i>	

*65 Receipts for prospectus*

*72 Order to provide information regarding distribution*

#### NI 41-101: GENERAL PROSPECTUS REQUIREMENTS

*5.2 Date of certificates*

*5.3 Certificate of issuer*

*5.4 Corporate issuer*

*5.9 Certificate of underwriter*

*6.5 Amendment to a preliminary prospectus*

*6.6 Amendment to a final prospectus*

#### **KERR V. DANIER LEATHER INC. [2007] SCC**

Only material changes would trigger a post-filing disclosure requirement. If a prospectus is compliant at the time of filing, then no amendment is triggered by a change in a material fact.

#### BCSA PART 11 CIRCULATION OF MATERIALS

*78 Waiting period*

*81 Defective preliminary prospectus*

*82 Material given on distribution*

*83 Obligation to send prospectus*

*84 Exemption order by commission or executive director*

#### NI 44-101 SHORT FORM PROSPECTUS DISTRIBUTIONS

### CONTINUOUS DISCLOSURE

30

*85 Continuous disclosure*

#### NI 51-102 CONTINUOUS DISCLOSURE OBLIGATIONS

*4.1 Comparative Annual Financial Statements and Auditor's Report*

*4.2 Filing Deadline for Annual Financial Statements*

*4.3 Interim Financial Statements*

*4.4 Filing Deadline for Interim Financial Statements*

*4.5 Approval of Financial Statements*

*4.6 Delivery of Financial Statements*

*4.9 Change in Corporate Structure*

*4.11 Change in Auditor*

*5.1 Filing of MD&A*

*5.4 Disclosure of Outstanding Share Data*

*5.5 Approval of MD&A*

*5.6 Delivery of MD&A*

*5.8 Disclosure Relating to Previously Disclosed Material Forward-looking Information*

*6.1 Requirement To File an AIF*

*6.2 Filing Deadline for an AIF*

*7.1 Publication of Material Change*

*8.2 Obligation to File a Business Acquisition Report and Filing Deadline*

*8.3 Determination of Significance*

*9.1 Sending of Proxies and Information Circulars*

*9.2 Exemptions from Sending Information Circular*

*9.3.1 Content of Information Circular*

*9.4 Content of Form of Proxy*

#### NI 58-101 AND NP 58-201 CORPORATE GOVERNANCE

### TIMELY DISCLOSURE

35

#### NP 51-201 DISCLOSURE STANDARDS

*2.1 Timely Disclosure*

- 2.2 Confidentiality
- 2.3 Maintaining Confidentiality
- 3.1 Tipping and Insider Trading
- 3.3 Necessary Course of Business
- 3.4 Necessary Course of Business Disclosures and Confidentiality
- 3.5 Generally Disclosed
- 3.6 Unintentional Disclosure
- 4.1 Materiality Standard
- 4.2 Materiality Determinations
- 4.4 External Political, Economic and Social Developments

#### **SUPERINTENDENT OF BROKERS V. PEZIM, PAGE, AND IVANY [1994] SCC**

The duty on senior officers to disclose material change within ten days includes a duty for senior management to keep informed of material info that exists so it can be disclosed as soon as practicable.

#### **RE PACIFICA PAPERS INC. [2001] BCSC**

Even if a transaction would be material change, entering into a lockup agreement for it is not a material change.

EXEMPT MARKET	40
---------------	----

PRIMARY MARKET: EXEMPTION FROM PROSPECTUS REQUIREMENT	40
---	----

#### **POLICY**

#### **NI 45-106 PROSPECTUS AND REGISTRATION EXEMPTIONS**

- 2.1 Rights Offering
- 2.2 Reinvestment Plans
- 2.3 Accredited Investor
- 2.4 Private Issuers
- 2.5 Family, Friends and Business Associates
- 2.8 Affiliates
- 2.9 Offering Memorandum
- 2.10 Minimum Amount Investment
- 2.11 Business combination and reorganization
- 2.12 Asset Acquisition
- 2.14 Securities for Debt
- 2.16 Takeover Bids and Issuer Bids
- 2.24 Employee, executive officer, director and consultant
- 2.26 Distributions among current or former employees, executive officers, directors, or consultants of non-reporting issuer
- 2.35 Short Term Debt

#### **BCSA PART 10 EXEMPTIONS FROM PROSPECTUS REQUIREMENTS**

- 76 Exemption order by commission or executive director

SECONDARY MARKET: RE-SALE OUTSIDE OF EXEMPT MARKET	45
--	----

#### **NI 45-102 RESALE OF SECURITIES**

- 2.3 Section 2.5 Applies
- 2.4 Section 2.6 Applies
- 2.5 Restricted Period
- 2.6 Seasoning Period
- 2.8 Exemption for a Trade by a Control Person
- 2.14 First Trades in Securities of a Non-Reporting Issuer Distributed under a Prospectus Exemption
- 3.1 Exemption

INSIDER TRADING	47
-----------------	----

**BCSA PART 7***57.2 Insider trading, tipping and recommending**57.3 Front running**57.4 Defences**87 Insider reports***R. v. R.BENNETT, H.DOMAN, AND W.BENNETT [1989] BC PC**

The criminal burden of proof is applicable in persecuting insider trading, and is very hard to meet.

**DONNINI V. ONSECCOM [2005] ONCA**

A reviewing court must show a high level of deference to a SecCom's decision on sanctions.

**R. v. FINGOLD [1999] ONCJ**

Something about honest reasonable belief that information is not material?

**R. v. HARPER [2000] ONCJ**

Insider Trading is a strict liability offence and defenses to it are either mistake of fact or due diligence, established by D on BP

**REGULATION OF TAKE-OVER BIDS**

51

**BCSA PART 13: TAKE OVER BIDS AND ISSUER BIDS***98 Making a bid**99 Recommendation relating to bid**114 Applications to the commission**115 Applications to the court***MI 62-104 TAKE OVER BIDS AND ISSUER BIDS***1.8 Deemed beneficial ownership**1.9 Acting jointly or in concert**2.2 Restrictions on acquisitions during take-over bid**2.4 Restrictions on acquisitions before take-over bid**2.5 Restrictions on acquisitions after bid**2.8 Duty to make bid to all security holders**2.9 Commencement of bid**2.10 Offeror's circular**2.11 Change in information**2.12 Change in terms of bid**2.17 Duty to prepare and send directors' circular**2.18 Notice of change**2.20 Individual director's or officer's circular**2.23 Consideration:**2.24 Prohibition of Collateral Benefit:**2.26 Proportionate Take Up and Payment:**2.27 Financing arrangements**2.28 Minimum deposit period**2.29 Prohibition on take up**2.30 Withdrawal of securities**2.32 Obligation to take up and pay for deposited securities**2.33 Return of deposited securities**2.34 News release on expiry of bid**4.1 Normal course purchase exemption**4.2 Private Agreement Exemption**4.3 Non-reporting issuer exemption**4.4 Foreign take-over bid exemption*

*5.2 Early warning**5.3 Acquisitions during bid*

## BRIEF OVERVIEW OF DEFENSE TACTICS 56

## NP 62-202: TAKE-OVER BID DEFENSIVE TACTICS

## SHAREHOLDER RIGHTS PLANS

## IN THE MATTER OF CANADIAN JOREX LTD. [1992] ON SEC COM

If the SRP is against public interest as declared by NP 62-202 it will be struck down

## NEO MATERIAL TECHNOLOGIES INC. AND PALA INVESTMENTS [2009] ON SEC COM

SRPs may be adopted to safeguard the long-term interest of SH, consistent with reasonable business judgements.

## ICAHN PARTNERS LP V. LIONS GATE ENTERTAINMENT CO [2010] BC SEC COM

If the defensive tactics does not stimulate and auction, such as an SRP with an impossible permitted bid, then the SH should be able to decide for themselves whether to tender into the take over bid.

## ENFORCEMENT GENERALLY 60

## BCSA PART 18 ENFORCEMENT

*155 Offences generally**155.1 Additional remedies**157 Order for compliance**159 Limitation period**160 Costs of investigation**161 Enforcement orders**162 Administrative penalty**163 Enforcement of commission orders*

## RE SIDDIQI [2005] BC SEC COM

An order under s.161 can be made for the purpose of general deterrence in the public interest.

## ENFORCEMENT OF FAILURE TO FILE OR DISCLOSE 62

*164 Failure to comply with filing requirements*

## PROSPECTUS DISCLOSURE FAILURE

## CONTINUOUS DISCLOSURE FAILURE

*89 Halt trading order*

## ENFORCEMENT OF MISREPRESENTATION 64

## BCSA PART 16: CIVIL LIABILITY

*131 Liability for misrepresentation in prospectus**132 Liability for misrepresentation in circular or notice**132.1 Liability for misrepresentation in prescribed disclosure document**140 Limitation period*

## BCSA PART 16.1: CIVIL LIABILITY FOR SECONDARY MARKET DISCLOSURE

*140.3 Liability for secondary market disclosure**140.4 Burden of proof and defences**140.5 Assessment of damages**140.6 Proportionate liability**140.6 Liability Limits**140.8 Leave to Proceed**140.94 Limitation Period*

## DEFENSE TO CIVIL LIABILITY

## FIAT V. LEASCO DATA PROCESSING EQUIPMENT CO. [1971] US

Completely independent and duplicate investigation not required to establish due diligence but BD are expected to examine documents that were readily available

**RE YBM MAGNEX INTERNATIONAL INC. [2003] ONSECCOM**

Future materiality and due diligence in failure to disclose.

**ENFORCEMENT OF INSIDER TRADING 69**

**CIVIL LIABILITY FOR INSIDER TRADING**

*136 Liability for insider trading, tipping and recommending*

*136.1 Accounting for benefits*

*136.2 Due diligence defence for insider trading*

**CRIMINAL LIABILITY**

*22.1 Offences of negligence — organizations*

*22.1 Other offences — organizations*

*380 Fraud*

*382 Fraudulent manipulation of stock exchange transactions*

*382.1 Prohibited insider trading*

**INVESTIGATION AND ADMINISTRATION 71**

**BCSA GENERAL**

*15 Revenue and expenditure*

*15.1 Claim for wrongful benefit*

*57.5 Obstruction of justice*

*57.6 Duty to comply with undertaking*

**BCSA PART 17: INVESTIGATION AND AUDITS**

*141 Provision of information to executive director*

*142 Investigation order by commission*

*143 Power of investigator*

*144 Investigator's power to compel evidence*

*150 Costs payable by person investigated*

**BCSA PART 19: REVIEWS AND APPEALS**

*165 Review of Decision of Executive Director*

*166 Review of Decision of Person Acting under Delegated Authority*

*167 Appeal of Commission Decision*

**REGISTRANT REGULATION 73**

**BCSA PARTS 5 – 7**

*34 Persons who must be registered*

*49 Calling at or telephoning residence*

*50 Representations prohibited*

*51 Registered dealer acting as principal*

*52 Disclosure of investor relations activities*

*57 Manipulation and fraud*

**NI 31-103: REGISTRATION REQUIREMENTS AND EXEMPTIONS**

## CAPITAL MARKETS

**Capital:** Money or any right to receive money. There is no limit on the form of the right to receive money. These can range from simple promises to pay a stated amount on a given date (promissory notes which are the safest of securities) to indications that an undetermined portion of an undetermined amount, existing at an undetermined date, may be paid (common shares, which are the riskiest of securities).

**Securities:** In the broad definition these are documents (contracts) offered in exchange for cash or other benefits which grant the purchaser a claim on future cash flows or other economic services. These can be stocks, bonds, debentures, options, futures, derivatives, or a whole shitload of other arrangements. The narrow definition includes only types of instruments presently traded, mainly bonds and stocks, the dealers trading them, and the financial markets in which they are traded.

**Liquidity:** The ability to convert securities into cash quickly at minimum cost and without a significant decrease in price caused by transaction.

**Liquid Securities:** Securities that can be easily sold at the FMV.

**Capital Markets:** Forums where different forms of capital change possession.

**Primary Capital Markets:** Trade in securities sold by their original issuer to obtain access to the necessary number of buyers at the same time.

**Secondary Capital Markets:** Trade in securities that are not currently in the possession of their creator. Holders of securities may obtain money for their securities immediately by selling them to third parties, rather than waiting until original issuer make payments pursuant to the right to receive money evidenced by them. In Canada, the main of these are the TSX, TSX:V, and Montreal Bourse, which is the main Canadian market for derivatives.

**Upstairs Market:** A network of trading desks for the major brokerage firms and institutional investors, which communicate with each other by means of electronic display systems and telephones to facilitate block trades and program trades, as opposed to trading on the stock exchange. This is a subset of an Over the Counter Market.

**Exempt Market:** Market of securities under NI 45-106. These securities are exempt from prospectus requirements and hence require less disclosure than a prospectus offering. To rely on the exemption provided in the instrument, an issuer must

**Issuer:** Any person who has a security outstanding, is issuing a security, or proposes to issue a security.

**Reporting Issuer:** Full definition on page 28. But most commonly it is an issuer that

- Has issued securities in respect of which a prospectus was filed and a receipt was issued,
- Has any securities that have been at any time listed and posted for trading on any exchange in BC, regardless of when the listing and posting for trading began

**Issue:** A sale of security by the original creator (issuer). This is sold through an underwriter to investors, either privately or by and IPO.

**Liquidation:** A sale of security by its holder who is not the issuer.

**Control Premium:** An amount that a buyer is willing to pay over the FMV of a SH. This premium is justified by the expected synergies, such as the expected increase in cash flow resulting from cost savings and revenue enhancements achievable in the merger. Normally, the control premium is industry-specific and amounts to 20–30% of the market capitalization of a CO calculated based on a 20 trading days average of its stock price.

- Every security sold by an issuer and remaining outstanding is available to buyers in the secondary capital market.
- Secondary market establishes the FMV of securities, so that issuer can figure out the amount of new securities they must sell to raise the money they require. Hence the interaction between the primary and secondary markets.
  - Holders of securities estimate their monetary value
  - Holders of money ascertain the merit of exchanging their money for securities.

For the purpose of describing capital markets, the economy is divided into two sectors:

- Real sector
  - This is comprised of persons, non-financial business, and governments. Let's call these economic units.
  - The decisions are made by some economic units to save, consume, or spend less than current income, while other units decide to spend more than they earn using the saving of former group to finance their deficiency. This creates transactions of flow of money between those who have a surplus due to savings, and those who have a deficit due to spending.
- Financial Markets
  - Accommodate the transfer of funds from surplus units to deficit units within the real sector



## 463.1 INTRODUCTION TO MARKETS AND SECURITIES

- This can be done directly by offering securities issued by the deficit units to the surplus units
- Or it can be done indirectly by financial institutions acquiring the claims of deficit units and then issuing new claims, which are tailored more closely to the requirements of surplus units.
- Financial institutions attract savings by issuing claims on themselves which are more liquid, less risky or of shorter term, process of intermediation.

### Primary and secondary capital markets serve following key purposes

1. Allow original issuers who have an immediate use for money to buy money by selling their securities
2. Permit original issuers to determine how much money they will receive for various kind of securities
3. Permit holders of money who have no immediate use to invest in securities
4. Permit holders of securities to liquidate their holdings for money

Fundamental basis of securities regulation is the protection of the public interest and maintaining efficient capital markets.

Efficiency of capital markets is the ability to fulfill its four primary purposes. It achieves these through:

- The channeling of savings
  - Markets channel funds from surplus units to deficit units.
- Reward for saving
  - Capital markets establish the rate of exchange between present dollar and future dollar.
  - Savings is the decision to postpone consumption
  - Future dollars are greater than present dollars by the return earned through savings
- Cost of Financing
  - Second purpose of financing market is to establish the cost of financing for the borrower and the rate of return on these financing vehicles for the lender.
  - Investment decisions are made based on the cost of funds on the basis of comparing the expected returns and perceived riskiness of the project on which he intends to invest in
  - The opportunity cost of financing is called cost of capital
  - Decision rule is to accept a capital investment proposal if its anticipated rate of return is greater than, or at the margin just equal to, the firm's cost of capital.
- Liquidity
  - Capital markets facilitate liquidity, transforming short-term funds to long-term use
  - Transformation allows much larger flow of savings to be made available for long-term investment, financial institutions do this through intermediation
- Providing a market that is equivalent with other secondary capital markets around the world
  - The more capital is available in a market, the more efficient the market is.
  - Thus a market is interested in keeping people trading at it.
  - Any market that is less efficient or more restrictive, will scare away investors, who will go and trade elsewhere.
- Value basis
  - Last purpose of financial market is to establish a basis for valuation

### DOMINANT MARKETS IN CANADA

- Money Market:
  - Handles short-term debt securities, usually of one year or less to maturity, issued by governments and both non-financial and financial COs.
  - Everything on this market is very liquid and investment-rate graded and safe.
  - It is a dealer market, where underwriting investment dealer or financial institution buys the offering from the issuing unit and then sells the securities in parts to financial institutions, COs and other institutions such as universities, or hold some of the issue itself.
  - This is mainly a primary market, trading of these instruments in secondary markets.
- Bond Market:
  - As opposed to the money market, the bond market deals with long-term debt securities, typically of 5 years or more.
  - The interest derived from bonds (called coupon) will depend on the risk rating on the security.
  - Has both primary and secondary operations. Investment dealers act as underwriters and buy the primary issue and distribute to financial institutions and the public.
  - The secondary market involves dealers buying bonds for and selling bonds from their own inventory.
  - This market also involves a large amount of hedge fund investors.
- Equity/stock market:

## 463.1 INTRODUCTION TO MARKETS AND SECURITIES

- Dealers underwriting corporate issues and distributing them to financial institutions and individual investors.
- Secondary equity markets are mainly auction markets where bids and offers are made by broker for their clients on listed stocks on a stock exchange
- Markets for some stocks not listed on exchange are maintained by dealer buying for and selling from their inventory
- Secondary Offerings: an underwriter acquires a block of stock from a stockholder and distributes it in much the same way as a primary issue in order to avoid putting stress on the secondary market by selling such a large transaction

### TYPES OF SECURITIES

All of the following are securities that are governed by a *Securities Acts*. See page 23.

#### DEBT FINANCE

**Debt Securities:** Create a debtor-creditor relationship between the securities holder and the CO. These are comprised of bonds, debentures, and notes.

- Debt is the more secure form of security which entitles its owner to a payout.
- Bank loans are the most basic forms of debt financing.
  - Short term bank loan is a revolving line of credit that allows the amount of loan to fluctuate up and down as need requires with a limit on the maximum amount available.
  - Long term bank loan is given on terms that provide the bank with some protection against loss. Bank usually takes a security interest in certain assets of borrower so it can seize them in event of bankruptcy.
- Commercial Papers carries an obligation on the part of the issuer to pay a specified amount (face value) on a specified date (maturity date). This is usually unsecured, have a maturity under 270 days, and higher interest rates than bonds.
- Bonds are debt securities in which the issuer owes the holder a debt, and is obliged to pay interest (coupon) and repay the principal at a later date, termed maturity. These are secured by taking an interest in one of more assets of the borrower
- Debentures are documents unsecured corporate bonds (except in UK, where it is usually secured).
- Special features of bonds
  - Call allows the borrower to purchase the bond after a specified date for a specified price.
  - Sinking funds provide for a fund to build up each year to redeem some portion of the bonds before maturity or to meet the obligation to pay at maturity.
  - Conversion right is a right to convert the bond into shares of the borrower. The most common hybrid is an “income” bond or debenture, which is a debt security on which interest is payable only to the extent covered by corporate earnings, making it less risky for the CO.

#### EQUITY FINANCE

**Equity Securities:** Shares of a CO that create a shareholder relationship.

**Shares:** A measure of interest of the holder, but not part ownership in assets or CO undertaking. This is the only form of security issued by a CO which represent an investment that doesn't result in a debtor-creditor relationship. It does not mean part ownership of CO's assets. Ownership of a share gives a SH a bundle of rights: chose in action, right to vote, and a certain right to proportionate part of assets (dividend or distribution of assets in winding up)

**Preferred Shares:** An equity security that resembles properties of both an equity and a debt instrument and generally considered a hybrid instrument. They usually carry no voting rights, but may carry priority over common stock in the payment of dividends and upon liquidation. They also can carry an obligation to pay dividend, albeit it not at a fixed rate, and it can be missed with less repercussions than a bond dividend. Preferred stock may have a convertibility feature into common stock.

#### COMMON SHARES

- A security that gives the holder a bundle of rights:
  - The right to vote on election of directors and major CO decisions
  - The right to dividends if such are declared, though there is no obligation to pay dividends
  - The liquidation right whereby common shares are entitled to share pro rata any proceeds of the liquidation. But their claim is the lowest on the ladder of claimants and creditors.

### PREFERRED SHARES

- One step above common shares, these are given a preference with respect to the distribution of dividends and often also to the proceeds of liquidation. As a trade off these are usually non voting. There are some varieties:
  - Cumulative (vs. Non-cumulative): if in a year dividends are either not declared or not sufficient to pay the full amount of the annual preferred dividend on the preferred shares, the amount unpaid carries over into the next year.
  - Participating (vs. Non-participating): participate in dividends beyond the specified preferred amount they are to receive in any given year.
  - Redemption/Call Provision allows the CO to buy back the shares from SHs at some future date for a specified price.
  - Retraction Rights permits the SH to tender the share to the CO and the CO has to buy back at some priced specified in advance.
  - Conversion: gives SH a right to convert the preferred share into a common share.

### RESTRICTED SHARES

- Like common shares, these have a right to pro rata share in dividends and on distribution of the proceeds of liquidation, but voting is restricted. Thus these are usually cheaper.
- This allows the CO to raise money without giving up control, allow to raise more capital for the same share structure.

### RIGHTS

- A CO has the option of raising funds by granting rights to existing SHs to buy additional shares through the sale of warrants. Most often these are sold as units, where a share is bundled up with a warrant and sold at a premium.
- Warrant is a right to buy shares from the CO for a specified price (exercise price) during specified period of time.
- Assures the CO that it will raise the amount of capital it is seeking through the issuance of additional shares.
- The rights to buy shares are normally tradable
- The CO is sometimes required by its articles to give right when issuing additional shares.

### OPTIONS

- Stock Market Options are derivative instruments that establish a contract between two parties concerning the buying or selling of an asset at a reference price during a specified time frame.
  - Call option are a right to buy
  - Put option are a right to sell
- COs will often grant options to agents and underwriters, directors, and employees.
- Employee stock options are usually non tradable

### UNITS IN A LIMITED PARTNERSHIP

- In a partnership each partner is personally liable for any debts incurred by business, but some have limited liability limited to investments of the limited partner.
- Often investment is effected through sale of units.
- There is a tax advantages for using units in LP instead of shares in CO: a loss of LP can be used to reduce taxes immediately, and not in some point in future when the business becomes profitable.

### UNITS IN BUSINESS TRUSTS

**Business Trust:** A trust that is set up for the purpose of carrying on business or for the purpose of investment. A trust is not recognized as a separate person, and it is the trustees who have the title to the assets and who can transact the business with those assets on behalf of beneficiaries. Investors can invest by setting funds on trustees who are charged with a duty to manage those funds on behalf of investors) (beneficiaries).

- Investor beneficial interests can be divided into units
- Since trustee has the authority to deal with the assets, it is the trustees who would be liable for shit that goes sour.
- Yet there are two main sources of liability for investors:
  - Right of trustees to be indemnified for their losses by beneficiaries in some situations

## 463.1 INTRODUCTION TO MARKETS AND SECURITIES

- Possibility that the trustees will also be considered agents of the investors in some situations
- Business Trusts derive their income from operating business.
  - These avoid double taxation of corporate income
  - Units are sold to public, and funds raised are invested in an entity that carries on business operations as a loan to a business. The terms of the loan allow for most of the before interest expense income of the operating entity to be distributed to the trustees as interest thereby reducing the taxable income of the operating entity.
  - These can be modified by inserting one or more LL entities between the trust fund and the operating entity.
  - In such a case, trustees own interest in LP and LP owns equity in operating entity:
- Mutual Funds pool investments from various investors and invest the funds in a portfolio of securities, allowing investors to obtain diversified portfolio at a lower cost. These provide investors with expertise through mutual fund managers
  - These can be set up as trusts for a tax advantage.
  - An open-end fund has no limit on the number of investment units sold and investors can redeem their investments directly from the fund by giving securities and getting cash in return.
  - A closed-end fund has a limited number of investment units and investors can't surrender their securities to the fund, having to sell in the market.
- Real Estate Investment Trust (REIT) is one that invest in real estate related things like land, mortgage loans, loans for construction, real estate equities. Funds come from sale of trust units and issuance of debt securities.
- Securitization Trusts are those whose units are sold as part of securitization assets. Somewhat similar to a REIT.
  - Securitization is the sale of securities that produce a return on investment from the cash flows generated by specific assets. Created securities are "asset-backed securities"
- Resource Trust is one where revenue comes from production or sale of commodities such as fossil fuel, minerals, metals, timber, or their byproducts.
- Utility Trusts are those whose main source of income comes from operation of utilities that provide services such as pipelines, telecommunications, light, power, water.

### INCOME DEPOSIT SECURITIES

- A repackaged security that contains different types of securities in one: often a common shares and subordinate notes of the issuer.
- With interest payments on the debt absorbing most of the profit before payment of interest on the debt could lead to the debt being treated as equity, interest on debt would be non-deductible and the CO would have to pay tax on the pre-interest profit.
- Income deposit security developed as an alternative to business income trust

### DERIVATIVE SECURITIES

**Derivative Security:** A security that derives its value from other underlying asset or variable such as price of security or commodity or level of an index, such as stock exchange index. These include swaps, futures, and options.

- These provide leverage such that a small movement in the underlying can cause a large movement in the the derivative.
- This generally derivative securities are riskier than the underlying assets
- But derivatives can be used to hedge against risk by entering into a derivative contract whose value moves in the opposite direction to their underlying position and cancels part or all of it out;
- A derivative is not a stand-alone asset, since it has no value of its own. However, more common types of derivatives have been traded on markets before their expiration date as if they were assets.

### ASSET BACKED SECURITIES

- A security whose value and income payments are derived from and collateralized (or "backed") by a specified pool of underlying assets. The pool of assets is typically a group of small and illiquid assets that are unable to be sold individually.
- Pooling the assets into financial instruments allows them to be sold to general investors, a process called securitization.

### GOVERNMENT SECURITIES

- Federal, provincial and municipal governments raise funds through sale of securities
- Government of Canada sells bonds, treasury Bills, and Canada Savings Bonds. The latter can be short and long term.

## SECURITIES REGULATION

### GOALS OF REGULATION

All security laws have same fundamental basis: protection of public interest in the fair and efficient operation of the capital market.

- There are two things to balance when designing a system of regulation: trust and efficiency (which relies on access).
- The Canadian system emphasises trust over efficiency.
- Maintaining efficiency of the market is necessary so that buyers and sellers of securities will desire to use market.
  - Buyers must have faith in the promise of being paid in exchange for parting with their cash.
  - Sellers must have faith in info the market is providing them.
- It is believed that buyers and sellers will have faith in the market if the market has integrity.
- Investor protection does not mean that investors don't ever lose money in the markets. It means that investors will be protected from faulty or incomplete information.

Efficiency is the relationship between the intrinsic value of the security and its price in the market. A high efficiency presents the closest relationship between the two. Efficiency depends on liquidity, information flow (conducive to informed analysis), and low transaction costs. Based on these three factors, there are three sub-sets of efficiency:

- External Efficiency
  - Has to do with activities of outsiders - investors and savers who are not brokers or dealers
  - This has to do with information and prices. A market where prices fully reflect the information available is externally efficient. This means that the market is open and the changes in price directly and immediately reflect the honest and reliable information provided about the COs.
  - Information must be freely available for this to work.
  - Cost of information gathering needs to be minimized to achieve high external efficiency. However, if the cost is shouldered by the COs, the external efficiency is maintained.
- Allocational Efficiency
  - Allocates capital to users in a way that those who are best able to use of capital will get the capital first.
  - This would create the ability of one opportunity to attract the funds before a seller has to create a opportunity that offers a lower "risk adjusted" return or a poorer "risk-return combination"
  - Policy objective is that What is profitable to one individual is not necessarily what is best for the nation.
  - Allocational efficiency is more important in the primary markets.
  - Is this what affects liquidity?
- Operational Efficiency
  - Market with low transaction cost allows investors to easily transfer their investments from one user of capital to another.
- Allocational efficiency needs both Operational Efficiency (to ensure that market prices are not distorted due to high and unstable transactional costs) and External Efficiency (to ensure that market prices accurately reflect the info available).
- Also, cheap transactions and fair prices inspire confidence in investors, causing them to invest and trade more frequently and to suit the changing times. This encourages investment and brings down the cost of capital for COs.
- Smaller markets tend to be less efficient. So how does one find the balance with smaller markets and smaller COs so that they are not over-burdened by the information disclosure costs?

**Strong Efficient Market Theory:** Share prices reflect all information, public and private, and no one can earn excess returns. If there are legal barriers to private information becoming public, as with insider trading laws, strong-form efficiency is impossible, except in the case where the laws are universally ignored.

**Semi-Strong Efficient Market Theory:** Share prices adjust to publicly available new information very rapidly and in an unbiased fashion, such that no excess returns can be earned by trading on that information. Semi-strong-form efficiency implies that neither fundamental analysis nor technical analysis techniques will be able to reliably produce excess returns.

**Weak Form Efficient Market Theory:** Share prices reflect all past publicly available information. Future prices cannot be predicted by analyzing prices from the past. Excess returns cannot be earned in the long run by using investment strategies based on historical share prices or other historical data. Technical analysis techniques will not be able to consistently produce excess returns, though some forms of fundamental analysis may still provide excess returns. Share prices exhibit no serial dependencies, meaning that there are no "patterns" to asset prices. This implies that future price movements are determined entirely by information not contained in the price series. Hence, prices must follow a random walk.

**Arbitrage:** The practice of taking advantage of a price difference between two or more markets: striking a combination of matching deals that capitalize upon the imbalance, the profit being the difference between the market prices. In academic vocabulary, an arbitrage is a transaction that involves no negative cash flow at any probabilistic or temporal state and a positive cash flow in at least one state; in simple terms, it is the possibility of a risk-free profit at zero cost.

**Adverse Selection:** A market process in which adverse results occur when buyers and sellers have asymmetric information: the low quality products that are more likely to be selected because they are cheaper and the buyer does not have the information to understand their quality. The aim of disclosure is to avoid the adverse selection problem.

- Due to costly process of providing info to make distinction in quality known, there are undisclosed distinctions in quality.
- In the world of adverse selection, lower quality drives out higher quality: if people are unable to discern between high and low quality products, they will not be willing to pay higher price for the higher quality products.
  - Lower quality products eventually drive out the high quality because no one's buying the latter.
  - This makes it unprofitable to make higher quality products and the whole market becomes a swamp of filth.
- Confidence in the market as a solution to adverse selection
  - Increased confidence in information means that investors are willing to pay more for securities.
  - This benefits the higher quality securities and more financial resources are be allocated to high quality securities improving allocation.
- Requiring full disclosure improves identification of higher quality securities

### TYPES OF REGULATION

- To maintain market integrity, most systems will regulate participants in the market, the securities in the market, and the info available in the market.
- Regulation of the participants in the marketplace
  - **Sellers of securities:** This is pretty straightforward. Sellers are required to register with regulatory authority, meet and maintain standards, and comply with regulations governing info to be made available to the market.
  - **Buyers of securities:** from retail investors to institutional investors, these need to be regulated, to prevent investor disappointment in the market. The larger the investor (more assets they control) the more sophisticated it is presumed, and the less information flow towards them is regulated. Smaller investors are protected by more onerous disclosure regulations.
  - **Intermediaries:** these are not interested in the outcomes of the transactions, since they make money on any transaction. They also have a tendency to make the market inefficient.
- Regulation of the securities in the marketplace.
  - There was not much regulation in this area, but recently there has been plenty of talk of need for more stringent regulations, such as the issues with the asset backed commercial papers.
  - There is no limit on creation of securities, but certain securities may be limited from sale because:
    - Some securities are prone to being abused, and impugn integrity of market
    - Some securities are too complicated to be understood by intended buyers.
    - This has been somewhat regulated by the "know your client rule" which prohibited brokers from buying securities which were inappropriate for their clients.
- Regulation of information available in the marketplace:
  - Buyer and seller must have all info which may affect share value (material information).
  - Statutory and civil liability is created for failing to disclose, or disclosing the incorrect info.
  - Risk is fundamental to establishing the value of a share. Similarly, the flow of information about the risk in the market is fundamental to the concept of regulation.

**Unsystematic Risk:** Company or industry specific risk that is inherent in each investment. The amount of unsystematic risk can be reduced through appropriate diversification.

**Systematic Risk:** The risk inherent to the entire market or entire market segment. Whereas this type of risk affects a broad range of securities, unsystematic risk affects a very specific group of securities or an individual security. Systematic risk can be mitigated only by being hedged.

**Systemic Risk:** The big one. The risk of collapse of an entire financial system or entire market, as opposed to risk associated with any one individual entity, group or component of a system. This refers to the risks imposed by interlinkages and interdependencies in a system or market, where the failure of a single entity or cluster of entities can cause a cascading failure, which could potentially bankrupt or bring down the entire system or market.

## SOURCES OF REGULATION

### CONSTITUTIONAL DIVISION OF POWERS AND HISTORY OF REGULATION

- Stock markets predate any sort of regulation. NYSX is the first stock exchange that originated some time in the early 1700s when some stock brokers started meeting in Manhattan under the Buttonwood tree. Pre Great Depression there was little organized regulation of securities and markets.
- In USA there are state security laws that are the basis for the blue sky commissions. But there is a provision that any CO that is listed on an exchange is exempt from state provisions. These are controlled by the SEC, which is the de facto regulator.
  - This came about as the result of the Great Depression, where the states were seen as unable to deal with the crisis using a patchwork of state laws.
  - Feds managed to bring in a federal regulating agency under interstate commerce and postage laws, which are under federal jurisdiction.
- In Canada, each province and territory has a securities regulator and statute, and there is no federal regulating agency.
  - This is because trading in securities is primarily done under provincial law through s.92: property & civil rights.
  - Even in cases overlapping but not conflicting between federal and provincial laws, the courts have upheld provincial law. This is because of a regulatory gap that could be created by not upholding provincial law when there is no federal law.
  - This is clearly a shitshow.
  - Most commonly transactions will fall under twin jurisdiction: the province where the CO originates, and ON, which is where most lenders or buyers are, or (in the case for listed COs) where the TSX is. There is substantial similarity between provincial laws and ON laws, but in case of the conflict, both sides will usually prefer a different *Securities Act*.

### **R. v. W. MCKENZIE SECURITIES LTD. [1966] MBCA** ***Inception of inter-provincial securities regulation***

**Facts:** A securities CO registered as a broker-dealer with the ONSecCom, carried on business from offices located in TO. One W was president, director and trading officer of the CO, and one D was a registered salesman for the CO. The CO sent literature and letters under the signature of W to a school teacher in MB in which subscriptions for the purchase of capital stock of various COs were solicited. Neither W nor D nor the CO was registered under the *MBSA*. As a result of these activities, the teacher made five different purchases of the stock of three COs. When one of the COs went into bankruptcy, the teacher complained to the authorities in MB, which resulted in the laying of charges that the CO, W and D had unlawfully traded in securities in MB without being registered to do so, in contravention of the *MBSA*. All three were convicted by the lower court and penalties were imposed. On appeal the CO contended that s. 3 of the *MBSA* did not apply to an incorporated CO inasmuch as "CO" and "person" were separately defined in s. 2 and s. 3 stated that "no person shall (a) trade . . .". W and D contended that their activities were lawful and constituted solely interprovincial trading, the regulation of which was within the exclusive legislative authority of the Parliament under s. 91(2) of the *B.N.A. Act*. Therefore to the extent that the *MBSA* could be said to have application to the activities of W and D it was ultra vires.

**Issue:** Can this be done?

**Discussion:**

- The court concluded that the *MBSA* could not justly be considered as designed in any way for the regulation of interprovincial trading and accordingly it did not make the domain of trade and commerce reserved to the federal government under the *B.N.A. Act*.
- Thus it was a valid provincial legislation, and any extraprovincial implications are merely incidental to trading of securities in MB.
- Included in the definition of trade or trading in s.2 of the *SA* was the "solicitation or obtaining of a subscription to the capital stock of an organization whether incorporated or not" which was precisely what W and D were engaged in doing.
- Accordingly, both W and D who were unlicensed in MB were found to have traded in securities in MB contrary to the *SA*.

**Ruling:** CO's appeal allowed. Appeals of W and D dismissed.

### PASSPORT SYSTEM

- The Passport system based on MI 11-102 started late 2004. Now all provinces but ON have signed on with it.
  - This is an administrative system where every market participant (applies to both issuers and registrants (dealers) has to deal with (and comply with the rules of) just one single regulator.
  - When a CO in BC wants to sell stock in AB, BC would be called the primary regulator and AB is the host.

## 463.2 REGULATION: GOALS AND SOURCES

- But a CO has to pay fees to both the host and the primary regulators, even though the host does not do anything.

**Primary Regulator:** Where the CO head office is, where the business is operating. It is responsible for overseeing the registrant.

**Host Regulator:** Has to defer to primary regulators jurisdiction and signing-off, and can't re-review what primary regulator decides.

- When dealing with ON, COs still use old mutual recognition system (MJDS). That is ON will 'recognize' what other province did but still needs to sign, may add their own stipulations.
- Administrative enforcement means that the host regulator is the only provincial SecCom to enforce rules, and the host court is the proper forum to decide, though the decision has to be rubber-stamped and enforced by the primary provincial court. This way COs won't get double-slammed by other provincial SecCom (but can still take complaints, and if primary regulator is not dealing satisfactorily with the problem, they can take a kick at the CO.)
- But in terms of civil liability passport system doesn't change anything. If a CO sell in all provinces, individuals can file civil action against you in all the different provinces.
- Advantages of the system:
  - Avoids inconsistent requirements which impede efficiency in the market
  - Retains attentions to regional concerns - which is something that might be lost with a federal regulator.
  - Allows for peculiar nature of canadian federalism, economy, and geography.
  - Competition between regulators can serve as a testing grounds for natural selection of the most effective rules.
- Disadvantages:
  - For the passport system to be effective different provincial regulation has to be harmonized. But 80% of capital market is in ON, which is too cool to play ball with the rest of the kids.
  - Cost. And a hugely excessive bureaucratic structure.
  - Counterargument to the "multiple laboratories for democracy" is the race to the bottom, where the lowest common denominator for corporate wild west will prevail.
  - There is still a lot of uncertainty and rules that aren't harmonized:
    - What is harmonization: is uniformity in principles enough or is there a need for the same rules?
    - If you have the same rules across jurisdictions, you are guaranteed more stability, whereas same principles guarantees more flexibility for local legislation. The West wants principle alignment, not rule alignment.

### BCSA PART 19.1: INTERJURISDICTIONAL COOPERATION

- In BC, it is Part 19.1 of *BCSA* is the statutory underpinning for the passport system.
- It gives BCSecCom the power to delegate their powers (when they are host regulator) to another province as primary regulator.
- These rules sounds somewhat confusing and technical, and the likelihood of them being on the exam is pretty slim.

#### **167.2 Delegation and acceptance of authority**

- BCSecCom may delegate its powers and duties under the *Act* to an extraprovincial SecCom.
- BCSecCom may authorize an extraprovincial SecCom to exercise any power, or perform any duty, of the executive director under this Act.
- Can accept delegation of extraprovincial authority

#### **167.3 Subdelegation**

- The BCSecCom may delegate or subdelegate an extraprovincial authority in the manner and to the extent that the BCSecCom or the executive director may, under this Act, delegate or subdelegate, or authorize another person to exercise, a BC authority.

#### **167.4 Revocation**

- If an extraprovincial SecCom is exercising or intends to exercise a power provided to it under section 167.2 to make a decision, BCSecCom may withdraw from them that matter
- BCSecCom can also revoke any delegation and subdelegation previously granted.

#### **167.5 Adoption or incorporation of extraprovincial securities laws**

- BCSecCom can adopt or incorporate by reference provisions of extraprovincial securities laws and apply it to persons, trade, security, or exchange.



### **167.6 Exercise of discretion, interprovincial reliance**

- If an extraprovincial commission has determined a matter BC can make a decision based on it.
- In such case, the person in question isn't given opportunity to be heard.

### **167.7 Review of Extraprovincial Decision**

- If an extraprovincial SecCom delegates or subdelegates a BC authority, section 165 applies to a decision made under that authority as if the decision were a decision of the executive director under this Act.

### **167.8 Appeal of Decision of an Extraprovincial Securities Commission**

- One can appeal an extraprovincial decision in the Court of Appeal. But to do this, one must first get leave.
- The extraprovincial SecCom is a respondent to an appeal under this section.

### **167.9 Appeal of Determination of Commission**

- If the commission has accepted an extraprovincial authority, this determination can also be appealed to the Court of Appeal.

**Canadian Securities Administrators:** is an association of 13 provincial and territorial securities regulators in Canada.  
**IOSCO:** The international equivalent of the CSA; an association of organizations that regulate the world's securities and futures markets.

## **MULTIPLE ACCESS V. MCCUTCHEON [1982] SCC**

***Provincial Securities Acts are not ultra vires, as long as they co-exists with federal corporate statutes.***

**Facts:** Appeal from the order of ONCA. The appeal raised the issue of the constitutionality of provincially, and federally enacted "insider trading" legislation and more specifically, very similar sections in provincial and federal statutes which dealt with the use of confidential information by insiders. The Ds in this appeal were "insiders" of the PL CO. On a motion made by two SHs of the CO it was ordered that the ONSecCom commence an action, in the name of and on behalf of the PL CO to enforce the liability created by alleged "insider trading" of the Ds. Before trial of the action the Ds moved the ONSC for a determination of a point of law. It was contended on behalf of the Ds that s. 113 and 114 of the *ONSA* were suspended and rendered inoperative by virtue of similar provisions in the *CBCA* and consequently they could not confer jurisdiction upon the Court to grant leave to the ONSecCom to commence action on behalf of the PL CO. When the trial court refused to accept the contentions of the Ds, they appealed to the ONSC which accepted their contentions and that decision was affirmed by the ONCA.

**Issue:** (1) were ss.100.4 and 100.5 of the *CBCA* ultra vires? (2) were ss.113 and 114 of the *ONSA* ultra vires? (3) assuming this, were the sections of the *ONSA* suspended and rendered inoperative in respect of COs like the PL incorporated under the laws of Canada?

### **Discussion:**

- All the questions were answered in the negative.
- The Court found that ss.100.4 and 100.5 of the *CBCA* put teeth into s. 100 of that Act. The provisions dealt with obligations attached to the ownership of shares in a federal CO, which extended to SHs, officers and employees of such COs, a subject matter that was not within the exclusive jurisdiction of provincial legislatures. The enactment by Parliament of these provisions was in discharge of its company law power.
- Sections 113 and 114 of the *ONSA* constituted valid legislative provisions in relation to the subject matter of property and civil rights in the province, with respect to trading of the capital securities of a CO. The sections did not sterilize the functions and activities of a federal CO nor did they impair its status or essential powers.
- The provincial legislation merely duplicated the federal, it did not contradict it.
- The fact that a plaintiff might have a choice of remedies did not mean that the provisions of both levels of government could not "live together" and operate concurrently.
- Sections 113 and 114 of the *ONSA* were not suspended or rendered inoperative in respect of corporations incorporated under the laws of Canada by ss.100.4 and 100.5 of the *CBCA*.
- Duplication is central to harmonization, which is a necessary consequence of a federal system. Thus provincial autonomy will trump federal economy.

**Ruling:** Appeal allowed.

### THE DEBATE FOR A NATIONAL REGULATOR

- Today Canada is the only major industrialized country without a national securities regulator.
- Canada's existing system of 13 provincial and territorial regulators is not without positive attributes. Its main strengths are the proximity of regulators to capital market participants in each jurisdiction and the development of expertise in specific industry sectors. Other strengths include its responsiveness to what are often characterized as local and regional issues.
  - But these strengths are significantly outweighed by serious weaknesses that must be promptly addressed.
- Canada suffers from inadequate enforcement and inconsistent investor protection. Policy development is characterized by compromise and delay. The system is too costly, duplicative and inefficient. The regulatory burden impedes capital formation. Canada's international competitiveness is undermined by regulatory complexity.
- The lack of a national Canadian securities regulator also raises wider concerns about systemic risk as there is no national entity accountable for the stability of our national capital markets.
- Calls for change have been common: see Wise Persons Committee in 2003 and the Expert Panel Report on Securities Regulation in 2009.
- In October 2009 the federal government said it will ask the SCC to rule on the constitutionality of a national securities regulator and will not proceed with legislation establishing such a regulator without the court's opinion.
- The Supreme Court is scheduled to hear the reference on April 13 and 14, 2011

### SOURCES OF PROVINCIAL REGULATION

#### **Sources of Regulation in BC:**

- *Securities Act*, RSBC 1996 (*BCSA*)
- Regulation to the BCSA
- Rules to BCSA
  - Only *BCSA* (including *Rules* and *Regulations*) have the force of law. These are administered by BCSecCom.
- By-laws and rules of Self-Regulatory Organizations.
  - By-laws and rules of SROs do not have force of law, but the *BCSA* authorizes BCSecCom to delegate to them the regulations. Which means that their breach will be treated like breach of law.
- Instruments of the provincial SecComs (NIs and MIs) that have force of law.
- Policy Statements of the provincial SecComs (NPs and Uniform Policies)

**Provincial and Territorial Security Acts:** Passed by each province's legislature dealing directly with security regulation. These set out skeletal framework for the regulation. Details and policies are in regulations or rules pursuant to powers granted by these acts.

**Provincial Regulations:** Have to be passed by the Lieutenant General through an order in council. Because of this, they take a long time to implement and are not as commonly used in securities law. If needed, these prevail over Rules. (s.183)

**Provincial Rules:** Can be implemented by the SecCom itself, empowered by the *SA*, with no outside authorization. These are more common in securities law. (s.184)

**National Instrument:** An instrument developed by all 13 sec commissions co-operatively and incorporated into the law of all provinces (BC does it via rules, using Notice & Comment process to incorporate the NI into law). On the day that an NI is incorporated, the provincial SecCom sends out a notice, through which the NI is empowered. Once it is incorporated, the NI has binding power.

**Multi-lateral Instrument:** An instrument issued by several provinces joined in issuing particular instrument.

**Companion Policy:** A document published along with the NI explaining how to use it. These are not binding, but one would be a fool to not read this.

**Policy Statement:** Issued by SecCom administrators in Canada indicating how they interpret the legislation, regulations or rules and providing guidance to market participants in complying with them. It also provide guidance as to how sec administrators are likely to exercise discretion. Like by-laws, these have no force of law but a breach can be treated like breach of law.

**Staff Notice:** Provided by SecComs, these contain info to those who deal with securities regulation on regular basis. These are intended to assist reporting issuers to understand staff's view of specific issues.

**Memoranda of Understanding:** Documents entered between different SecComs in Canada or with foreign SecComs. These must all be forwarded to the Minister who must approve or reject these within 60 days.

## 463.2 REGULATION: GOALS AND SOURCES

- The rule making power of a SecCom is subject to procedural requirements, which vary among jurisdictions. In BC these originate from s.180 of the *BCSA*. The procedural requirements include:
  - Notice & Comment Rule making: A review and comment process for making and amending rules;
  - A SecCom must publish a rule it proposes to make and give 90 days for comments;
  - Similar requirement for material changes to the rule, where the SecCom must publish the proposed changes and provide a period for comments;
  - In BC the consent of the Minister is required for making or repealing a rule.
  - This rule comes out of *Ainsley* and *Pezim*, where the court found that if the SecCom is empowered to make rules, then it must be subject to some process of accountability.

**Commission Rulings:** SecCom decisions are an important source of law. They can be appealed to courts and courts decisions of appeal are another important source of law. Is SecCom bound by precedent?

**Blanket Orders:** SecComs used to issue these, and these would apply to anyone who would fit the terms of the order, with no need to go to the administrator to get a separate order. But the validity of these was questioned. Now same orders and same facts are addressed through making of a rule or instrument

### BRITISH COLUMBIA SECURITIES COMMISSION

- Note that most of this applies to ONSecCom, or any other SecCom in Canada.
- BCSecCom is an independent, autonomous, administrative tribunal, and the general powers of admin tribunals apply.
- The mandate of the BCSecCom is to protect the investing public from reprehensible activities such as fraud, manipulation, & misconduct in the marketplace.
- Its goal is to ensure investors have full, true, and plain disclosure of material facts in disclosure documents relating to publicly-offered securities, and accurate continuing info to assist investor to arrive at informed investment decisions in secondary market transactions
- *BCSA* contains recognition of special expertise of the SecCom, and its need to be able to respond relatively quickly.
- It is hard to pinpoint practice of BCSecCom because decisions are rarely available in writing, and practices may change without notice.
- BCSecCom is responsible to the Lieutenant Governor (LG) through the Minister of Finance. LG has power make regulations and to appoint and remove by order-in-council any of the commissioners from office.
- BCSecCom has the power to grant, suspend, and cancel registration of COs.
- It imposes a fair standard conduct in dealings between parties (often issuing policy statements to meet a perceived abuse).
- SecCom can delegate its power to the Superintendent (CEO)
- Any decision of Superintendent can be appealed once and reviewed (as per s.155(?), but these are final and cannot be appealed again.
- Any person directly affected by decision can appeal to the BCCA as per s.157 but only with leave of a BCCA justice.
- Decisions of SecCom and its Executor Director generally are only applicable to parties to the decision.
  
- Structure of the SecCom
  - At the top is the Chairman and six Commissioners. These are the administrative tribunal.
  - Immediately subordinate to these and reporting to them is the Executive Director.
  - ED is in charge of all of the branches, including the enforcement branch. This makes him “chief prosecutor”
  - Chairman is expected to serve on full-time basis, while others are part-time.
  - There are no particular qualifications, but it is generally desirable to have legal background.

Rule making provisions of the SecCom are set in *BCSA* ss.184-188:

- s.184 – Commission rules
- s.185 – *Regulations Act* applies to commission rules
- s.186 – Regulation prevails over Commission rule
- s.187 – Administrative powers respecting commission rules
- s.188 – Policy Statements

**SELF-REGULATORY ORGANIZATIONS**

**Self Regulatory Organization (SRO):** A non-governmental organization. Its purpose is to regulate operations, standards of practice, and business conduct of its members and their representatives, with a view to promoting the protection of investors and the public interest. The BCSecCom currently recognizes two SROs: the Investment Industry Regulatory Organization of Canada (IIROC) [dealers have to register with IIROC] and Mutual Fund Dealers Association.

- Another source of regulation is from industry associations.
- An arrangement under which SROs are looked to by a government agency to apply controls over its members in the public interest, in circumstances where the agency might otherwise apply such controls directly.
- TSX is the most important one of these for the matters of this course.
  - TSX has two major sets of rules: one applying to TSX, the other to TSXV.
- Advantages for effective system:
  - Government agency can devote resources to other activities
  - Industry association may be able to employ more effective disciplinary techniques than government agency
  - Business practices and moral standards are more readily understood by people in the industry
  - Industry association can be organized on a national basis without any constitutional difficulties
- The problem with SRO is they have no power of enforcement besides for kicking the guilty party out (delisting if TSX).
  - But this will fuck over the investors of the delisted CO, and since SecCom is a fan of public interest, it is most rare.
  - So SROs will usually go to the relevant securities regulator prior to the extreme punitive action of delisting
- Part 4 of the *BCSA* (ss.23-33) deals with the SROs in BC.
  - The regulatory regime should make appropriate use of SROs that exercise some direct oversight responsibility for their respective areas of competence, to the extent appropriate to the size and complexity of the markets.
  - The regulator should require an SRO to meet appropriate standards before allowing it to exercise its authority.
  - SROs should be subject to the ongoing oversight of the regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.

**24 Recognition**

*On application, the commission may recognize a person as*

- (a) a self regulatory body,*
- (b) an exchange,*
- (c) a quotation and trade reporting system, or*
- (d) a clearing agency.*

**26 Duty to regulate, conduct and provide information**

*(1) Subject to this Act, the regulations and any decision made by the commission, a self regulatory body, an exchange or a quotation and trade reporting system must regulate the operations, standards of practice and business conduct of its members or participants, and the representatives of its members or participants, in accordance with its bylaws, rules or other regulatory instruments.*

**27 Powers of the commission**

- (1) If the commission considers it to be in the public interest, the commission may make any decision respecting the following:*
- (a) a bylaw, rule or other regulatory instrument or policy, or a direction, decision, order or ruling made under a bylaw, rule or other regulatory instrument or policy, of a self regulatory body, an exchange, a quotation and trade reporting system or a clearing agency;*
  - (b) the procedures or practices of a self regulatory body, an exchange, a quotation and trade reporting system or a clearing agency;*
  - (c) the manner in which an exchange carries on business;*
  - (d) the trading of securities or exchange contracts on or through the facilities of an exchange, or the trading of securities on or through the facilities of a quotation and trade reporting system;*
  - (e) an exchange contract trading on an exchange;*
  - (f) a security listed on an exchange or quoted on a quotation and trade reporting system;*
- (2) A person affected by a decision made by the commission under subsection (1) must act in accordance with the decision.*

**30 Records of transactions**

*(1) An exchange or a quotation and trade reporting system must keep a record showing the time and date when each transaction on the exchange or quotation and trade reporting system was recorded.*

### PUBLIC OFFERING

- Any CO distributing securities to a open (non-exempt) market has to go through the IPO prospectus process.
- For a number of reasons, Canadian COs go IPO earlier than the US COs, largely because of the regulatory system, and a previous lack of established venture capital markets.
- An IPO is a complex, lengthy, and costly process, but it is usually the best way to raise a larger amount of money, because of the broad distribution that can be made under the offering.

#### **Some of the persons and agencies involved in the IPO process:**

- **Issuer:** The CO going public or floating additional shares;
- **Lead Underwriter:** The agency that buys the shares from the CO to resell them to the investors. Gets the largest fee, but undertakes most responsibility. The fee can be structured as a bought deal or on best efforts basis. A lead underwriter would have to conduct their necessary due diligence, trying to make sure the CO is what it says it is by going through management documents, books, etc.
- **Underwriting Syndicate:** A group of investment banks that share underwriting risk in respect to an issuer's securities. These contract directly with the issuer;
- **Banking Groups:** These allow the underwriter and the CO to further share the risk of the IPO. They are a subset of a syndicate, but they are not a part of it, in the sense that the banking group has a contract with the underwriter and not with the issuer;
- **Company Auditors:** These are involved in vetting the financial documents of the issuer;
- **Financial Printer:** Makes copies of the prospectus. A surprisingly lucrative business;
- **Transfer Agent:** Delivers the prospectus to the potential buyers, and then delivers the shares to new SHs, three days after the close;
- **Secondary Sellers:** During the sale of the new shares, some of the existing SHs may want to sell their shares.
- **Roadshow Consultant:** The majordomo who plans the pre-sale roadshow and pitches the shares to the investors.
- **Clearing House:** Often serves as the intermediate legal/registered owner of the shares while the investor becomes the beneficial owner of the shares. Clearing houses keep the records of who beneficial owners are. Clearing houses also posit themselves as a central counterparty and simplifies mass transfers by netting all transactions between brokers and notifying them of net obligations (money and securities). There are three clearing houses in Canada: Canadian Depository for Securities, Canadian Derivative Clearing House, Canadian Payments Association;
- **Canadian Depository Services:** Canada's national securities depository, clearing and settlement hub supporting Canada's equity, fixed income and money markets, holding over \$3 trillion on deposit and processing over 250 million domestic securities trades annually.
- **SecCom:** Gets to vet and approve the prospectus, and can send it back if there are deficiencies.

Procedurally speaking:

- CO retains the services of an underwriter to sell the offering which is evidenced via an underwriting agreement;
- CO announces the offering, applies for TSX approval and for listing of the shares, and then prepares and files with the SecCom a preliminary prospectus, which is then vetted by SecCom staff;
  - SecCom approval does not actually check the materiality of the information in the prospectus, merely the presence of all the information required by the NI.
- SecCom issues deficiency comments in a Comment Letter; the CO enters Clearance Period when it works to resolve those deficiency comments and once that process is complete SecCom staff gives the CO clearance to file the final prospectus.
- CO files the final prospectus, and once it has a receipt for the final prospectus from the SecCom, then the CO is free to close the offering.
- The closing consists of a cheque being delivered from the underwriters, less the commission, in exchange for the certificate or certificates representing the shares.

**Bought Deal Underwriter:** An arrangement where the only profit that an underwriter makes is that of the profit margin between the price that they pay per share to the CO, and the price that they sell the shares to the public. Underwriter takes the whole of risk, since in the case that not all shares are sold, the underwriter ends up with them.

**Best Efforts Underwriter:** An arrangement where the underwriter makes the profit by having a per share commission on the shares sold. Underwriter uses their best efforts to sell all the shares, and in the case that this does not work out then the issuer is stuck with the leftovers.

## 463.3 PUBLIC OFFERING AND PROSPECTUS DISCLOSURE

- As underwriters have to sign off on the prospectus and can incur heavy liability, they have an obligation to obtain info and to actively investigate, not rely on the CO's work. They should be almost adversarial toward their issuers.
- It might be hard to be adversarial as all other underwriters want to be the lead underwriter, and sometimes the timeline doesn't allow for deep investigation. Often there are also power issues within the firm as first year associates would do the due diligence.
- *YBM Magnex* is a recent case which involved an underwriter that failed to meet its due diligence standard. See somewhere below.

### PROSPECTUS

#### FORM OF THE PROSPECTUS

**Long Form Prospectus:** A prospectus filed in the form of Form 41-101F1(Standard) or Form 41-101F2 (Investment Fund). All IPOs require a Long Form Prospectus.

**Short Form Prospectus:** A prospectus filed in the form of Form 44-101F1. An issuer has to qualify for this by having filed a Long Form Prospectus in the past, and filing an Annual Information Form.

**Preliminary Prospectus:** Prior to release to the public, the issuer must submit to the regulator a preliminary, either long form or short form. Its purpose is to allow scrutiny by regulators before public starts to rely on it. Preliminary prospectus is substantially similar in form to the final, but does not contain the final issue price, interest amount, dividend amount, etc.

**Clearance Period:** Once the preliminary prospectus is approved, and a receipt is given to the issuer, the issuer must file the final prospectus within 90 days.

- In the application package sent along with the preliminary prospectus, the issuer has to include:
  - Auditor's comfort letter
  - Technical reports
  - Consent letter
  - Underwriting Agreement
  - Material contracts
  - Resolution of BD approving prelim prospectus
  - Financial statements/etc.
- Receipt for preliminary prospectus is issued if there is substantial compliance. Vetting process is not merit review: it merely looks to ensure required items have been disclosed.
- After the deficiencies from preliminary prospectus have been resolved, the issuer submits the final prospectus.
- Prospectus provides information relevant to assessing the value of the securities, and reducing information asymmetry.
- It must contain full, true and plain disclosure of all material facts relating to the securities being offered;
- Long Form prospectus has to include the following (where does all of this come from??)
  - The number and type of securities offered;
  - The method of distribution to public; and proceeds to the issuer;
  - The use of proceeds of the issuance;
  - The name and structure of the issuer CO or other form of business organization;
  - Description of issuer's business and development of business in the past three years;
  - Attributes of securities offered;
  - List of directors and executive officers, occupation over the past five years, ownership of securities of issuer/ subsidiaries, and their executive compensation;
  - Indebtedness of directors or executive officers to the issuer (or indebtedness where the issuer is guarantor);
  - Info on principal SH;
  - Factors that make purchase a risk or speculation;
  - Arrangement with underwriters and underwriting discounts or commissions;
  - Recent financial statements, MD&A,
  - Certificates as per NI 41-101 Part 5.
  - Right to withdraw within two days of receiving final prospectus;
  - Statement that in cases of misrepresentation the SHs have the right to rescind and get damages.

**PROSPECTUS REQUIREMENTS****61 Prospectus required**

- (1) *Unless exempted under this Act, a person must not distribute a security unless*
- (a) *a preliminary prospectus and a prospectus respecting the security have been filed with the executive director, and*
  - (b) *the executive director has issued receipts for the preliminary prospectus and prospectus.*
- (2) *A preliminary prospectus and a prospectus must be in the required form.*

So prospectus is required when there is a distribution which involves a security. This is a bit of a loaded statement and may need some unpacking.

**Distribution:** (as defined in *BCSA* s.1)

- (a) a trade in a security of an issuer that has not been previously issued,
- (b) a trade by or on behalf of an issuer in a previously issued security of that issuer that has been redeemed or purchased by or donated to that issuer
- (c) a trade in a previously issued security of an issuer from the holdings of a control person (So a control person wishing to sell their securities may have to comply with prospectus requirements, unless exempt)

**Deemed Distribution:** Resale of securities purchased under an exemption is deemed to be distribution. For example, sale by exempt purchasers to un-exempt ones trigger “distribution” and prospectus requirement, unless if it meet the resale rules. A deemed distribution is called such under s.76 by the SecCom or the executive director, or deemed such by regulations.

**Trade:** (as defined in *BCSA* s.1)

- (a) 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 ... for the purpose of giving collateral for a debt,
- (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);

So basically anything an owner or trader does to move securities for consideration

**Security:** (as defined in *BCSA* s.1)

- (a) a document, instrument or writing commonly known as a security,
- (b) a document evidencing title or an interest in the capital, assets, property, profits, earnings or royalties of a person,
- (c) a document evidencing an option, subscription or other interest in or to a security,
- (d) a bond, debenture, note or other evidence of indebtedness, share, stock, unit, unit certificate, participation certificate, certificate of share or interest, preorganization certificate or subscription other than:
  - a. a contract of insurance issued by an insurer, and
  - b. an evidence of deposit issued by a savings institution,
- (e) ...
- (f) an agreement providing that money received will be repaid or treated as a subscription to shares ...
- (g) a profit sharing agreement or certificate,
- (h) a certificate of interest in an oil, natural gas or mining lease, claim or royalty voting trust certificate,
- (i) an oil or natural gas royalty or lease or a fractional or other interest in either,
- (j) a collateral trust certificate,
- (k) an income or annuity contract, other than one made by an insurer,
- (l) an investment contract, (these are explained by the following case law)

**Investment Contract:** A contract by which one party undertakes to pay regular proceeds from an enterprise to the other in consideration for investment into the enterprise. These may be misleading on the face. Defined by US courts via a series of tests, this definition being endorsed by SCC in *Pacific Coast Coin Exchange v. O.S.C.*

**S.E.C. v. C.M. JOINER LEASING CORPORATION [1943] US SC**

*The reach of securities regulation extends beyond the statutory definition of security.*

**Facts:** An oil prospector in Texas had 3,000 acres of oil and gas land. He tried to raise money for exploration and drilling by selling leasehold interest in small (no more than 20 acres) bits of the property. Notably, the leaseholds were sold at random as units, and people could not pick the ones they wanted. It was clear that the investors would earn a profit through the oil drilling, although nothing specific was said of the arrangement. People paid more than price of the land here, in the hope that the CO will drill and find oil.

**Issue:** whether this was sale of “security”?

**Discussion:**

- USSC said that it is clear that CO was selling more than just naked leasehold. The purchasers are betting on finding oil.
- This not just selling an interest in land, but selling something akin to a security, as there is a chance that this will be an investment.
- Though there is a definition in the securities legislation of what is a security, the reach of the legislation should not be limited to it. Security regulations should not be read in a strict way that would limit their use.
- Under purposive approach the interpretation need to be flexible to promote the purpose of the act

**Ruling:** S.E.C. FTW.

**S.E.C. v. W.J. HOWEY CO. [1946] US SC**

*Establishes the Common Enterprise Test definition to and Investment Contract*

**Facts:** D CO owned a hotel in Florida and took its visitors on guided tours of nearby citrus groves that he owned. There they would be offered a real estate K for a single row of trees, with a related service K that gave the land in lease to the sister CO that would tend and harvest the trees. The purchaser would have no right of entry and no right to the product harvested, just the percentage of proceeds from the sale. The money from the deal would be used by D CO for business. Furthermore most people buying the Ks were not farmers but hotel visitors.

**Issue:** Whether land contract and service contract amounted to “investment contract”?

**Discussion:**

- It is important that there was no way to hold the land as a farm viably, as the strips were too small.
- The customers would not own individual fruit, but rather get a percentage of the profits, after the fruit have been pooled together and sold.
- The customers could also do nothing else with the oranges than contribute them to the pool for profits.
- PL claimed that this is a investment K. D claimed its a land K, as there is no share certificate.
- US SC found this to be an investment K. They also defined an Investment K through the Common Enterprise Test.

**Ruling:** Against D.

**STATE OF HAWAII V. HAWAII MARKET CENTER INC. [1971] HWI SC**

*Established the Risk Capital Test definition to Investment Contract*

**Facts:** Something about a store in which only members could shop. Two levels of membership were offered, the higher being the 500 founder members. Prospective FMs were told that they would be eligible to earn (1) immediate income before the store became operational, and (2) future income after the store became operational. One would become a FM by purchasing appliances for above market value and recruiting new members off whose purchases they would receive a commission, on top of getting a percentage of overall proceeds from the store.

**Issue:** Is this an “investment contract”?

**Discussion:**

- As some of the investors were able to derive profit on their own via recruiting new members, this would not pass under Common Enterprise Test.
- But *Howey* is too narrow and mechanical, as the profit is expected “solely” from third party effort.
- More purposive and broad approach is to look at the economic reality of transaction.
- The court held that an investment K existed even though certain investors in a retail store could generate profits through their own efforts, and therefore did not rely solely on the efforts of a third party.
- Though not embraced by the federal courts, the Risk Capital Test is applied by many states in ascertaining the existence of an investment K.

**Ruling:** Against D



**Common Enterprise Test:** Note that this is slightly adjusted in Canada as per *Pacific Coast Coin Exchange*.

A K is an investment K if it has the following features:

- One of the parties invests money,
- The money is invested into a common enterprise,
- The profits are expected solely from third party efforts,
- The definition should be interpreted flexibly.

**Risk Capital Test:** A K is an investment K if it has the following features:

- One of the parties invests money,
- All or some of value of the money is subject to risk of the enterprise,
- The furnishing of the initial value was induced by promises or representations of the other party leading to expectation of profit or valuable benefit of some kind to the investor,
- The investor doesn't have practical control over enterprise, and its success depends significantly on third party efforts.

### **PACIFIC COAST COIN EXCHANGE V. ONSECCOM [1977] SCC**

*Canada accepts US tests as stated in Howey, Hawaii and Joiner Leasing*

**Facts:** PL's activities consisted of offering for sale and selling bags of silver coins on margin. The customers entered into commodity account K with the PL which covered or hedged its obligation to its customers by purchasing future Ks for the silver and by maintaining a small inventory of silver coins in specie. PL had a policy of covering not less than 95% of its margin obligations. Then the price of silver dropped 50% and PL was stuck with all the future K's that they could not meet. The investors tried to get their silver out, none of which PLs had. ONCA dismissed the PL's appeal and held that the sales of silver coins by commodity account Ks by the PL constituted dealing in securities, hence the PL was required to comply with the requirements of *ONSA*.

**Issue:** Was PL dealing in "securities"?

**Discussion:**

- After a review of decided cases relevant to the matter from Canadian and US Courts the majority of the court concluded that the transactions between the PL and its customers constituted investment Ks.
- The court preferred the broader approach if tests carefully formulated in prior decisions prove ineffective and must continually be broadened in scope.
- So flexibility should always be on the side of the regulator, and substance prevails over form.
- The goal of securities regulation is not just to kill of fraudulent schemes, but to ensure adequate disclosure in all.
- To achieve this, the *Howey*, *Hawaii*, and *Joiner Leasing* are now law in Canada.
- As for the technical interpretation of the tests:
  - "solely" in the *Howey* is whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.
  - "Common enterprise" is an enterprise in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment or of third parties.
- Laskin dissents. Fuck him.

**Ruling:** Appeal dismissed.

### **BCSA PART 9 PROSPECTUS REQUIREMENTS**

- *BCSA* provides the core provisions for the prospectus requirements, but the actual content of prospectus is dictated by by NI 41-101.
- *BCSA* s.61 is above, stating that prospectus is required when there is a distribution which involves a security.
- But apparently NI 51-102 has taken the reigns as the regulation for future oriented financial information (FOFI), which constitutes a significant part of the prospectus. So one should check that shit out too.

#### **62 Voluntary filing of prospectus**

*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.*

#### **63 Contents of prospectus**

(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.*

**64 Executive director's discretion**

- (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.
- (2) The executive director may accept a form of prospectus or preliminary prospectus that is in accordance with the law of another jurisdiction if it contains full, true and plain disclosure of all material facts relating to the security to be distributed.

**65 Receipts for prospectus**

- (1) Subject to section 64(1), the executive director must issue a receipt for a preliminary prospectus as soon as practicable ...
- (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.
- (3) The executive director must not refuse to issue a receipt ... without giving the person who filed the prospectus an opportunity to be heard.

**72 Order to provide information regarding distribution**

- (1) If a person proposing to make a distribution of previously issued securities of an issuer is unable to obtain from the issuer information or material that is necessary to enable the person to comply with this Part or the regulations, the executive director may order the issuer to provide to that person the information and material that the executive director considers necessary.
- (2) The information and material supplied under subsection (1) may be used by the person to whom it is provided for the purpose of complying with this Part and the regulations.
- (3) If a person proposing to make a distribution of previously issued securities of an issuer is unable
  - (a) to obtain any or all of the signatures to the certificates required by this Part and the regulations, or
  - (b) to comply otherwise with this Part and the regulations,
 the executive director may make an order exempting that person from any of the provisions of this Part or the regulations, on being satisfied that
  - (c) the person has made all reasonable efforts to comply, and
  - (d) no person is likely to be prejudicially affected by the failure to comply.

**NI 41-101: GENERAL PROSPECTUS REQUIREMENTS**

## CERTIFICATES

- Prospectuses have to be accompanied by the certificates of the issuer stating that “this is full, true and plain disclosure of all material facts...” and of the underwriter stating that “to best of my knowledge and belief this is full, true and plain disclosure...”
- Thus underwriters get off a little easier.

**5.2 Date of certificates**

The date of the certificates in a prospectus or an amendment to a prospectus must be the same as the date of the prospectus or the amendment ...

**5.3 Certificate of issuer**

- (1) Except in ON, a prospectus must contain a certificate signed by the issuer. (In ON these are imposed by s.58 of the ONSA.)
- (2) A prospectus certificate that is required to be signed by the issuer under this Instrument or other securities legislation must be in the applicable issuer certificate form.

**5.4 Corporate issuer**

- (1) Except in ON, if the issuer is a CO, a prospectus certificate that is required to be signed by the issuer ... must be signed
  - (a) by the CEO and the CFO of the issuer, and
  - (b) on behalf of the board of directors, by
    - (i) any two directors of the issuer, other than the persons referred to in paragraph (a) above, or
    - (ii) if the issuer has only three directors ... all of the directors of the issuer.
- (2) Except in ON, if the regulator is satisfied that either or both of the CEO or CFO cannot sign a certificate in a prospectus, the regulator may accept a certificate signed by another officer.

**5.9 Certificate of underwriter**

- (1) Except in ON, a prospectus must contain a certificate signed by each underwriter who, with respect to the securities offered by the prospectus, is in a contractual relationship with the issuer ...securities are being offered by the prospectus. (See s.59(1) of ONSA in ON)
- (2) A prospectus certificate that is required to be signed by an underwriter under this Instrument or other securities legislation must be in the applicable underwriter certificate form.

## AMENDMENTS DURING PROSPECTUS PROCESS

**6.5 Amendment to a preliminary prospectus**

(1) *Except in ON, if, after a receipt for a preliminary prospectus is issued but before a receipt for the final prospectus is issued, a material adverse change occurs, an amendment to the preliminary prospectus must be filed as soon as practicable, but in any event within 10 days after the day the change occurs.*

**6.6 Amendment to a final prospectus**

(1) *Except in ON, if, after a receipt for a final prospectus is issued but before the completion of the distribution under the final prospectus, a material change occurs, an issuer must file an amendment to the final prospectus as soon as practicable, but in any event within 10 days after the day the change occurs.*

**KERR V. DANIER LEATHER INC. [2007] SCC**

**Only material changes would trigger a post-filing disclosure requirement. If a prospectus is compliant at the time of filing, then no amendment is triggered by a change in a material fact.**

**Facts:** *Danier* filed a prospectus on May 6, 1998, for an IPO of its common shares. The prospectus contained a forecast of estimated results to June 27, 1998, the end of *Danier's* fiscal year. The IPO closed on May 20, 1998. Prior to the closing, management became aware of certain facts (unusual warm weather) that might have resulted in CO's failure to achieve the forecast, but management continued to believe that CO would in fact achieve its forecast. On June 4, 1998, after further results became available, CO issued a press release revising its fourth-quarter forecast downward. As a result, the CO share price dropped. Subsequently, CO's business results improved and the original forecast was substantially achieved by June 27, 1998. But a class action suite was began for misrepresentation in prospectus and failure to amend the prospectus in time.

**Issue:** Is a forecast a representation? Must a final prospectus, once filed and received by the regulators, be updated if new material facts emerge post-filing but before closing?

**Discussion:**

- When a prospectus is accurate at the time of filing, ON securities law limits the obligation of post-filing disclosure to notice of a material change and does not require an issuer to amend a prospectus.
- When an issuer has fully complied with the securities law requirements with respect to disclosure in a prospectus, including the filing of an amendment in respect of a material change, it would be inconsistent with ON securities law to impose civil liability against the issuer for failing to disclose post-filing information that is not a material change.
- A change in an issuer's "results of operations" from those forecast will not necessarily constitute a material change. This will only be the case if the change in "results of operations" from those forecast stems from an underlying change in the business, operations or capital of the issuer.
  - In the circumstances at bar, the intra-quarterly shortfall in forecasted revenue did not constitute a material change, but a material fact.
- Business Judgment Rule may not be used to limit a public CO's disclosure obligations under applicable securities laws.
- As for the disclosure of FOPI, the judgment of the SCC here has left open the question of whether there is an implied representation regarding objective reasonableness at law.
- There was, an implied representation in the the prospectus that the forecast of results was prepared using objectively reasonable facts and assumptions. However, that implied representation was made only as of the date of the prospectus, prior to the change in results of operation.

**Ruling:** Class action dismissed with costs to PL.

**BCSA PART 11 CIRCULATION OF MATERIALS**

**Waiting Period:** The interval between the issue of a receipt for a preliminary prospectus and the issue of a receipt by for the final prospectus in respect of the same distribution.

**Cooling-Off Period:** Under s.83(3), this is the two day period when the agreement to purchase the securities under a prospectus is not binding on the purchaser.

**78 Waiting period**

- (2) *Despite section 61, but subject to Part 7, during the waiting period for the distribution of a security, a dealer or the issuer of the security may*
- (a) *communicate with a person*
    - (i) *identifying the security proposed to be distributed,*
    - (ii) *stating the price of the security, if determined,*
    - (iii) *stating the name and address of a person from whom purchases of the security may be made, and*

- (iv) *stating further information permitted or required by the regulations, so long as the dealer or issuer states the name and address of a person from whom a preliminary prospectus may be obtained,*
- (b) *give out a preliminary prospectus, and*
- (c) *solicit expressions of interest from a prospective purchaser, so long as ... a copy of the preliminary prospectus is sent to the purchaser.*

- So during the waiting period, underwriters may go and contact prospective investors - usually institutional investors - as long as they provide a copy of the preliminary prospectus.
- A preliminary prospectus is headed by a batch of red warning text that makes readers aware that it's not final.
- But there are limits on what one can do during the waiting period. One can't advertise.
- But this seems like a pretty vague line between soliciting and advertising. The former is about alerting the investors to the existence of the CO, the latter is about promoting the merits of the CO.

### **81 Defective preliminary prospectus**

*If the executive director considers that a preliminary prospectus does not substantially comply with section 63(1), the executive director may, without giving notice, order that trading that is permitted by section 78(2) ... cease until a revised preliminary prospectus satisfactory to the executive director is filed and sent to each recipient of the defective preliminary prospectus in accordance with the regulations.*

### **82 Material given on distribution**

*From the date of issue of a receipt for a prospectus relating to a security, a person distributing the security may give out*

- (a) *the prospectus,*
- (b) *any record filed with or referred to in the prospectus, and*
- (c) *any record used in section 78(2)(a).*

### **83 Obligation to send prospectus**

- (1) *A dealer, not acting as agent of the purchaser, who receives an order for a security [with a prospectus] must send to the purchaser,*
  - (a) *before entering into the written confirmation of the agreement of purchase and sale resulting from the order or subscription, or*
  - (b) *not later than midnight on the second business day after entering into the agreement,**the latest prospectus filed ... and any amendment to that prospectus.*
- (2) *Despite subsection (1), a dealer is not required to send an amendment to a prospectus to a purchaser if the agreement of purchase .. has been entered into before the obligation to file the amendment arises.*
- (3) *An agreement of purchase and sale referred to in subsection (1) is not binding on the purchaser [if the purchaser declines it within 2 days of receipt of the prospectus]*
- (4) *Subsection (3) does not apply if the purchaser*
  - (a) *is a registrant,*
  - (b) *...*
- (5) *For the purposes of this section, subject to subsection (7), receipt of the latest prospectus, and any amendment to the prospectus, that the purchaser is entitled to receive under this Act, by a dealer who*
  - (a) *is acting as agent of the purchaser, or*
  - (b) *after receipt begins to act as agent of the purchaser,**with respect to the purchase of a security referred to in subsection (1), is deemed to be receipt by the purchaser on the date on which the dealer received the prospectus and any amendment to that prospectus.*

### **84 Exemption order by commission or executive director**

- (1) *If the commission or the executive director considers that to do so would not be prejudicial to the public interest, the commission or the executive director may order that a person or class of persons is exempt from one or more of the requirements of this Part or of the regulations relating to this Part.*
- (2) *An order under subsection (1) may be made on application by an interested person or on the commission's or the executive director's own motion.*

- Under NI 41-101 distribution under the prospectus can continue for 12 month from date of final receipt.
- In the Passport System, MI 11-102 Part 3 regulates the prospectuses
  - Every province has to accept your prospectus and you have to pay fees in every jurisdiction
  - But only the principal regulator has to do actual vetting
  - Principal regulator is the jurisdiction where the issuer's head office located, or where the most substantial connection
- There is a Canada - US Multi Jurisdiction Disclosure System (MJDS), which is essentially the same as the Passport System, allowing for cross-border prospectus co-ordination.

### NI 44-101 SHORT FORM PROSPECTUS DISTRIBUTIONS

- As per Part 3 of NI 44-101, an issuer that is qualified to file a short form prospectus may file a short form prospectus.
- The details of qualification are explained in NI 44-101.
  - Issuer must be a reporting issuer in at least one jurisdiction of Canada. That is it must have filed a long form prospectus in an IPO.
  - The issuer has filed a current AIF in at least one jurisdiction.
  - The issuer has filed with the securities regulatory authority in each jurisdiction in which it is a reporting issuer all periodic and timely disclosure documents that it is required to have filed in that jurisdiction
  - The issuer has filed current financial statements in at least one jurisdiction.
  - The issuer's equity securities are listed and posted for trading on a short form eligible exchange

Benefits of a short form prospectus.

- Faster as there is a shorter review process.
- Cheaper as there is less printing costs, and issuer doesn't have to include annual financial statements & material change reports, which are incorporated by reference, "info available on SEDAR"
- It used to be that only "senior" COs could use the short form prospectus, because there was a minimum market capitalization threshold (CAD\$75 million). But a few years ago, the CSA decided to get rid of that requirement.
- Therefore now, the result is that we see very few issuers filing long form prospectuses, except in the context of IPO. Many COs are being persuaded by investment bankers to use the short form system, because generally it is considered to be a faster process, and speed is everything in capital markets.

## CONTINUOUS DISCLOSURE

### **85 Continuous disclosure**

*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.*

This essentially creates two obligations for disclosure:

- Prescribed periodic disclosure regarding business and affairs: this is periodic disclosure.
- Disclosure of a material change: this is timely disclosure.
- Since the *BCSA* is so laconic, we have to rely on the rules for clarification. NP 51-201 FTW.
- Note that this is only applicable to reporting issuers. A private CO is not bound by s.85.

#### **Reporting Issuer:** *BCSA* s.1

- (a) has issued securities in respect of which
  - (i) a prospectus was filed and a receipt was issued,
  - (ii) a statement of material facts was filed and accepted, or
  - (iii) a securities exchange take over bid circular was filed,
 under a former enactment,
- (b) has filed a prospectus or statement of material facts and the executive director has issued a receipt for it under this Act,
- (c) has any securities that have been at any time listed and posted for trading on any exchange in British Columbia, regardless of when the listing and posting for trading began,
- (d) is an issuer that has exchanged its securities with another issuer or with the holders of the securities of that other issuer in connection with an amalgamation, merger, reorganization, arrangement or similar transaction if one of the parties to the amalgamation, merger, reorganization, arrangement or similar transaction was a reporting issuer at the time of the amalgamation, merger, reorganization, arrangement or similar transaction,

**Market Impact Test:** The approach to materiality taken by the Canadian regulators and laid out in the two definitions below, which gauge materiality based on the significant effect on the market price of the security.

**Material Change:** If used in relation to an issuer other than an investment fund, it is

- 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
- A decision to implement such change made by the directors of the issuer (or senior management if they believe that directors' approval is imminent).
  - 51-102 also expands this to "a decision by persons acting a similar capacity to the BD"

**Material Fact:** Means, a fact that would reasonably be expected to have a significant effect on the market price or value of the securities.

**Reasonable Investor Test:** The US approach to materiality somewhat similar to ours. Information is material where if it were generally available a reasonable person would expect it to have a material effect on the price or value of securities.

**Probability/Magnitude Test:** Materiality of future events is based on a balancing of both the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company activity (that is, its effect on the share price?). As per *YBM Magnex*.

## NI 51-102 CONTINUOUS DISCLOSURE OBLIGATIONS

**Executive Officer:** Chair, vice-chair, or president, a vice-president in charge of a principal business unit, division or function including sales, finance or production; or anyone performing a policy-making function in respect of the issuer;

**Forward-Looking Information (FLI):** Information about prospective events, conditions, and results that is based on assumptions about future economic conditions.

**Future Oriented Financial Information (FOFI):** Means FLI about prospective results of operations, financial position or cash flows, based on assumptions about future economic conditions and courses of action, and presented in the format of a historical balance sheet, income statement or cash flow statement. Misrepresentation would be hard to prove here since one would have to prove that assumptions were unreasonable at the time they were made).

## 463.4 CONTINUOUS AND TIMELY DISCLOSURE

**Financial Outlook:** FOFI about prospective results of operations, financial position or cash flows that is based on assumptions about future economic conditions and courses of action and that is not presented in the format of a historical balance sheet, income statement or cash flow statement.

**Interim Period:** In the case of a year other than a transition year, a period commencing on the first day of the financial year and ending nine, six or three months before the end of the financial year

**Venture Issuer:** A reporting issuer that does not yet have any securities trading on any stock exchange.

- So the difference between FLI and FOFI, is that FOFI is the FLI which deals with prospective results of operations, financial position or cash flows, and is based on assumptions about future economic conditions and courses of action? Seems a little technical to me.

### PART 4 FINANCIAL STATEMENTS

#### **4.1 Comparative Annual Financial Statements and Auditor's Report**

- A reporting issuer has to file an audited AFS, which is to include:
  - An income statement, a statement of retained earnings, and a cash flow statement for the most recently completed financial year; and the financial year immediately preceding the most recently completed financial year, if any;
  - A balance sheet as at the end of each of the period
  - Notes to the financial statements.
- Notes have to include any changes to accounting policies; related party transactions; acquisitions; debt, etc.

#### **4.2 Filing Deadline for Annual Financial Statements**

- Reporting issuers have to file the AFS within 90 days from the end of the financial year
- Venture issuers have to file the AFS within 120 days.

#### **4.3 Interim Financial Statements**

- IFS has to be filed every quarter, and include quarter over quarter financial results (Q2 2010 over Q2 2009)
- But the IFS does not have to be audited, as long as warning a note is included that the IFS is not audited.
- If an auditor was hired but did not complete the review of the IFS, this also has to be disclosed.

#### **4.4 Filing Deadline for Interim Financial Statements**

- IFS has to be filed within 45 days of the end of the quarter.
- For venture issuers, this is 60 days.

#### **4.5 Approval of Financial Statements**

- AFS and IFS have to be approved by the board of directors prior to being filed. This approval can be delegated to an Audit Committee.

#### **4.6 Delivery of Financial Statements**

- Reporting issuers must annually send request forms to see which of its SHs (registered and beneficial owners) wish to receive the AFS and IFS.
- If any SH requests to see an AFS or IFS from the past two years, issuer must send a copy within 10 days from receipt.

#### **4.9 Change in Corporate Structure**

- If an issuer is party to a transaction that resulted in the issuer becoming or ceasing to be a reporting issuer, changing its financial year end, or its name, then the issuer must file as soon as practicable a detailed description of the transaction.
- Exemption is available under s.91 where SecCom is of the opinion it wouldn't be prejudicial to the public interest.

#### **4.11 Change in Auditor**

- Upon a termination or resignation of its auditor the issuer has to prepare a form that explains the reasons for the change of auditor, which has to be signed off by the auditor. At the same time the auditor prepares their own form, and the two are filed with SecCom and SEDAR. All of this is under s.4.11(5)
- Upon an appointment of a successor auditor, a reporting issuer must go through the similar process with the newly appointed auditor. All of this is under s.4.11(6)
- Any reportable events (disagreement, a consultation, or an unresolved issue) that have occurred between the former (or new) auditor and the issuer have to be disclosed in the notice.
- The complete disclosure content of the notice is in s.4.11(7)

## 463.4 CONTINUOUS AND TIMELY DISCLOSURE

- This section does not apply if the following three conditions are met:
  - A termination or resignation occur in connection with an amalgamation, arrangement, takeover or similar transaction involving the reporting issuer or a reorganization of the reporting issuer;
  - It has been disclosed in a news release that has been filed or in a disclosure document delivered to SHs
  - No reportable event has occurred;
  - Or the change of auditor arises from an amalgamation, merger or other reorganization of the auditor.

### PARTS 4A AND 4B FLI AND FOFI AND FINANCIAL OUTLOOKS

- A reporting issuer must not disclose FLI unless the issuer has a reasonable basis for the FLI.
- Under s.4A.3, a reporting issuer that discloses material FLI must include disclosure that:
  - Identifies FLI as such.
  - Cautions users of fFLI that actual results may vary from the FLI.
  - States the material factors or assumptions used to develop FLI.
- This applies to everything written, not to oral statements.
- Pretty much the same applies to FOFI
- In addition to the disclosure required by s.4A.3, if a reporting issuer discloses FOFI or a financial outlook, the issuer must also include disclosure that
  - States the date management approved the FOFI or financial outlook, if the document containing the FOFI or financial outlook is undated; and
  - Explains the purpose of the FOFI or financial outlook and cautions readers that the information may not be appropriate for other purposes

### PART 5 MANAGEMENT DISCUSSION AND ANALYSIS

#### **5.1 Filing of MD&A**

- A reporting issuer must file MD&A relating to its AFS and IFS on the same date as the AFS and the IFS (more or less).
- The format of an MD&A is to follow that prescribed in 51-102-F1.
- The MD&A is to contain narrative, plain language explanation from management's perspective of how the reporting issuer performed during the period, so that investors can understand what financials show.
- Also, the MD&A should discuss future prospects, trends and risks, quality and potential viability of reporting issuer's earnings and cash flow to help investors determine if past performance is indicative of future performance
- It must disclose any material information that may not be reflected in financial statements.
- Because of all of this, the MD&A is more forward-looking than AIF.

#### **5.4 Disclosure of Outstanding Share Data**

- A reporting issuer must disclose in its MD&A the designation and number or principal amount of each class and series of voting or equity securities of the reporting issuer for which there are securities outstanding, or options and warrant convertible.

#### **5.5 Approval of MD&A**

- MD&A has to be approved by the BD prior to being filed. This approval can be delegated to an Audit Committee.

#### **5.6 Delivery of MD&A**

- Similar process as for delivery of AFS/IFS under s.4.6.
- If requested by a SH, the issuer must send an MD&A within 10 days of the receipt of the request.

#### **5.8 Disclosure Relating to Previously Disclosed Material Forward-looking Information**

- A reporting issuer must discuss in its MD&A events that occurred during the period that are reasonably likely to cause actual changes to material FLI for a period that is not yet complete that the issuer previously disclosed.
- Any difference in actual results and those previously prognosed by FLI should be discussed in the MD&A.
- An issuer can also withdraw previously announced FLI in the MD&A.
- This applies to all FLI except for that delivered in an oral statement.

### PART 6 ANNUAL INFORMATION FORM

- AIF draws together all of the information provided by issuer on annual basis, and expresses it in plain language.



## 463.4 CONTINUOUS AND TIMELY DISCLOSURE

- 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.
- Form 51-102F2 outlines the matters to be addressed:
  - 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.
  - There are specific requirements for issuers mineral projects, oil & gas activities, outstanding asset backed securities, etc.
- So AIF different from and Annual Report, which is not prescribed by regulations, nor is monitored by the SecCom.

### **6.1 Requirement To File an AIF**

- A reporting issuer that is not a venture issuer must file an AIF.

### **6.2 Filing Deadline for an AIF**

- AIF must be filed on or before the 90th day after the end of the reporting issuer's most recently completed financial year.

## PART 7 MATERIAL CHANGE REPORTS

### **7.1 Publication of Material Change**

- If a material change occurs in the affairs of a reporting issuer, the CO must
  - Immediately issue and file a news release authorized by an executive officer disclosing the nature and substance of the change; and
  - As soon as practicable (within 10 days of the change), file a Form 51-102F3.
- If issuing a news release is “unduly detrimental” to the CO’s interest (in the opinion of the issuer arrived in a reasonable manner), or if a material change decision has been made by a senior management, but has not yet been approved by the BD and as long as nobody is trading on the information, a mere confidential filing to SecCom will suffice, explaining the reasons why disclosure would be harmful.
- The confidentiality of this filing is to be reviewed every 10 days.

## PART 8 BUSINESS ACQUISITION REPORT

### **8.2 Obligation to File a Business Acquisition Report and Filing Deadline**

- Requires issuer to file BAR within 75 days of completing a significant acquisition
- A BAR is to comply with Form 51-102F4 describing:
  - Business acquired, effect on issuer, consideration paid, source of funds, plans for material changes in issuer, or acquired, prior valuations of acquired business,
  - It is to include financial statements of acquired business and pro forma financial statements of the issuer showing the effect of acquisition.

### **8.3 Determination of Significance**

- For a non-venture issuer, an acquisition of a business or related businesses is a significant acquisition, if it satisfies any of the three significance tests:
  - The Asset Test. The reporting issuer’s proportionate share of the consolidated assets of the business or related businesses exceeds 20 percent of the consolidated assets of the reporting issuer calculated using the audited financial statements of each of the reporting issuer and the business or the related businesses for the most recently completed financial year of each that ended before the date of the acquisition.
  - The Investment Test. The reporting issuer’s consolidated investments in and advances to the business or related businesses as at the date of the acquisition exceeds 20 percent of the consolidated assets of the reporting issuer as at the last day of the most recently completed financial year of the reporting issuer ended before the date of the acquisition, excluding any investments in or advances to the business or related businesses as at that date.
  - The Income Test. The reporting issuer’s proportionate share of the consolidated income from continuing operations of the business or related businesses exceeds 20 percent of the consolidated income from continuing operations of the reporting issuer calculated using the audited financial statements of each of the reporting issuer and the business or related businesses for the most recently completed financial year of each ended before the date of acquisition.

There are tons of other rules here, but most of them are beyond the scope of this course.

## 463.4 CONTINUOUS AND TIMELY DISCLOSURE

### PART 9 PROXY SOLICITATION AND INFORMATION CIRCULARS

#### **9.1 Sending of Proxies and Information Circulars**

- If a meeting of SHs is to be held, management must send out to each registered SH:
  - Notice of the meeting
  - Management Information Circular (also known as Director's Circular)
  - Form of Proxy
- These have to be sent 30 days prior to the meeting.

#### **9.2 Exemptions from Sending Information Circular**

- Reporting issuer with fewer than 15 SHs are exempt from having to send out the MIC
- A dissident SH may solicit proxies without sending a IC, if the solicitation is made public via broadcast, speech, or publication, and a long as a short form IC is filed with the regulator.

#### **9.3.1 Content of Information Circular**

- The content of the Information Circular is dictated by Form 51-102F5
  - Any proposed motions for the meeting.
  - Salaries, bonuses, compensation and interests of NEO and director compensation. Also the discussion how this compensation was established.
  - The above disclosure must be in line with Form 51-102F6 Statement of Executive Compensation.
  - Also SH return on each class of shares.
  - Must include disclosure from NI 58-101 Governance practices (see below)

#### **9.4 Content of Form of Proxy**

- Must disclose in bold: who is soliciting the vote; if its management, who management wants you to vote for (and you can only vote yes or no); state your right to have someone other than management attend and vote for you (you write that person's name down).
- Note that under s.119 of the *BCSA*, an issuer can apply to be exempt from certain proxy requirements.

### NI 54-101 COMMUNICATION WITH BENEFICIAL OWNERS OF SECURITIES OF A REPORTING ISSUER

**Registered Owner:** means, for a security, the person or CO shown as the holder of the security on the books or records of the issuer.

**Beneficial Owner:** Means, for a security held by an intermediary in an account, the person or CO that is identified as providing the instructions ( or has the authority to do so) contained in a client response form.

**Objecting Beneficial Owner:** A beneficial owner that objects to his intermediary disclosing ownership information about the beneficial owner. Ownership information is name, address, etc.

**Non Objecting Beneficial Owner (NOBO):** A beneficial owner that does not object to his intermediary disclosing ownership information about the beneficial owner.

- When an issuer needs to issue forms of proxy, it has to ask the clearing house and the banks to figure out who the beneficial owners are.
- This has to be done 30-60 days prior to the AGM
- For this to happen, the issuer has to contact the depositories and clearing houses to get a list of intermediaries. After the receipt of the list, the issuer has to contact the intermediaries for the information about OBOs and NOBOs.
- After this a long and complicated sequence of communication rules follows, intended to help OBOs keep their identity secret, and still receive the materials.

### NI 58-101 AND NP 58-201 CORPORATE GOVERNANCE

#### NI 58-101 DISCLOSURE OF CORPORATE GOVERNANCE PRACTICES

- This applies to all reporting issuers, except for investment funds, and foreign issuers.
- This is largely incorporated into NI 51-102 and is to be included in the back of a MIC.

## 463.4 CONTINUOUS AND TIMELY DISCLOSURE

- If management of a non-venture issuer solicits a proxy for the purpose of electing directors it must include in its MIC (or AIF) the disclosure required by Form 58-101F1, which identifies every director who is independent.

### NP 58-201 CORPORATE GOVERNANCE GUIDELINES

- This applies to all reporting issuers, except for investment funds.
- But it is a policy, so it is not exactly binding.
- Note that any CO listed on TSX or TSXV will have to also follow the corporate governance obligations under that exchange's rules.

#### Board:

- BD should have a majority of independent directors, and the chair must be independent.
- The independent directors should hold regularly scheduled meetings at which non-independent directors and members of management are not in attendance.
- BD should adopt a written mandate in which it acknowledges responsibility for the stewardship of the issuer.
- BD should develop clear position descriptions for the chair of the board and the chair of each board committee.
- BD should ensure that all new directors receive a comprehensive orientation.
- BD should provide continuing education opportunities for all directors.
- BD should adopt a written code of business conduct and ethics, and be responsible for monitoring the compliance.

#### Committees

- BD should appoint a nominating committee composed entirely of independent directors, with a written charter and guidelines.
- The nominating committee should be responsible for identifying individuals qualified to become new board members and recommending to the board the new director nominees for the next annual meeting of shareholders.
- BD should appoint a compensation committee composed entirely of independent directors, with a written charter and guidelines.
- The compensation committee should be responsible for compensation? I guess so.

**Named Executive Officers (NEO):** CEO, CFO and the 3 next highly paid management.

**Independence:** As defined in NI 52-110 s.1.4, this is the standard definition for most NIs and NPs

- A member is independent, if he or she has no direct or indirect material relationship to the issuer.
  - A “material relationship” is a relationship which could, in the view of the issuer's BD, be reasonably expected to interfere with the exercise of a member's judgement.
- There is a list of individuals deemed to have a material relationship:
  - Employee or NEO of the issuer over the past 3 years, or a family member of such;
  - A partner or employee of issuer's auditor or a family member of such;
  - A NEO of a CO whose compensation committee included the NEO of the issuer;
  - Anyone who received more than \$75,000 from the issuer a direct compensation in the past year.
    - Direct compensation does not include remuneration paid for services as a director or a committee member.

## TIMELY DISCLOSURE

- Timely disclosure is the disclosure of material changes. It is intended to provide investors with access to up-to-date information, to improve the valuation of securities, and to allow them to make timely decisions.
- NI 51-102 Part 7 has obligations for timely disclosure of material changes and Part 8 has obligations to file business acquisition reports. See above for details.

### NP 51-201 DISCLOSURE STANDARDS

- National Policy 51-201 is a best practices guide that provide guidance for “best disclosure” and addresses concerns regarding selective disclosure of material corporate info.
- This is a policy, not an instrument, which means that most of the time there is no strict obligation to do anything here.

#### 2.1 Timely Disclosure

- A CO must disclose a material change in their business within 10 days of the change, even prior to approval by directors.
- The announcements of material changes should be factual and balanced.

## 463.4 CONTINUOUS AND TIMELY DISCLOSURE

- Note that this only applies to the material change.
- This means that a CO does not have to disclose all material facts on a continuous basis.

### 2.2 Confidentiality

- If the harm to a CO's business from disclosing outweighs the general benefit to the market of immediate disclosure, withholding disclosure is permitted by regulation.
- But the CO must make a confidential filing to the SecCom.

### 2.3 Maintaining Confidentiality

- Where disclosure of a material change is delayed, a CO must maintain complete confidentiality.
- If the confidential material change, or rumours about it, have leaked or appear to be impacting the share price, CO should take immediate steps to ensure that a full public announcement is made.
- This is in place to ensure that there is no insider trading or tipping.

### 3.1 Tipping and Insider Trading

- This applies to both material information and material change.
- This is essentially the restating of the insider trading and tipping prohibition from the *BCSA*
- Anyone in CO, or in a special relation with it, and with knowledge of undisclosed material information shall not trade in its securities, or advise anyone to trade in its securities.
- Nor shall they inform anyone of the undisclosed information, save when this is done in NCOB.
- Special relationship is defined in the *BCSA*
- Because the "special relationship" definition is so broad, it is important that COs establish corporate disclosure policies and clearly define who within the CO has responsibility for corporate communications.

### 3.3 Necessary Course of Business

- This is the exception to the tipping and insider trading prohibition.
- Whether the event has occurred NCOB is a mixed question of law and fact.
- Disclosure by a CO regarding a private placement may be in the NCOB for CO to raise financing.
- The NCOB exception would not generally permit a CO to make a selective disclosure of material information to an analyst, institutional investor or other market professional, unless if they are "within a chinese wall"
- NCOB exception exists so as not to unduly interfere with a CO's business activities, including communications with:
  - Vendors, suppliers, strategic partners on R&D, marketing, and supply contracts
  - Employees, officers, and board members
  - Lenders, legal counsel, auditors, underwriters, other advisers
  - Parties to negotiations
  - Labour unions and industry associations
  - Government agencies and non-governmental regulators
  - Credit rating agencies.

### 3.4 Necessary Course of Business Disclosures and Confidentiality

- If CO discloses material info under NCOB exception, it must make sure that those receiving info understand that they cannot pass the info onto anyone else, or trade on the info, until it has been generally disclosed.
- This should go beyond a mere confidentiality agreement, as such does not prevent tipping.

### 3.5 Generally Disclosed

- The tipping prohibition stops a CO from disclosing non-public material info to anyone, other than NCOB before the CO generally discloses it.
- "Generally disclosed" is usually considered satisfied when:
  - Info has been disseminated in a manner calculated to effectively reach the marketplace &
  - Public investors have been given a reasonable amount of time to analyze the info
- A CO may satisfy the "generally disclosed" requirement by using one or several of the following methods:
  - Widely circulated news or wire service.
  - Announcements made by press conferences or conference calls that interested members of the public may attend.
  - Posting info to a CO's website will not, by itself, be likely to satisfy the generally disclosed requirement.

### 3.6 Unintentional Disclosure

- If a CO makes unintentional disclosure, it must take immediate steps to ensure that a full public announcement is made.

## 463.4 CONTINUOUS AND TIMELY DISCLOSURE

### 4.1 Materiality Standard

- This is a repeat of the *BCSA*. Materiality is a two part test. A fact is material when:
  - It significantly affects the market price or value of a security, or
  - It would reasonably be expected to have a significant effect on the market price or value of the sec

### 4.2 Materiality Determinations

- The materiality of a particular event or piece of information may vary between COs according to their size, the nature of their operations and many other factors, such as market conditions

### 4.4 External Political, Economic and Social Developments

- COs are not generally required to interpret the impact of external political, economic and social developments on their affairs.
- However, if an external development will have or has had a direct effect on the business and affairs of a CO that is both material and uncharacteristic of the effect generally experienced by other COs engaged in the same business or industry, the company is urged to explain, where practical, the particular impact on them.
- For example, a change in government policy that affects most COs in a particular industry does not require an announcement, but if it affects only one or a few COs in a material way, such COs should make an announcement.

#### EXAMPLES OF POTENTIALLY MATERIAL INFO

Changes in Corporate Structure	<ul style="list-style-type: none"> <li>• Change in share ownership or control</li> <li>• Major reorganizations, amalgamations, mergers</li> <li>• Take-over bids, issuer bids, insider bids</li> </ul>
Changes in Capital Structure	<ul style="list-style-type: none"> <li>• Public or private sale of additional securities</li> <li>• Planned repurchases or redemptions of securities</li> <li>• Share consolidations or splits</li> <li>• Changes in dividend policies</li> <li>• Proxy fight</li> <li>• Changes of rights of security holders.</li> </ul>
Changes in Financial Results	<ul style="list-style-type: none"> <li>• Significant increase or decrease in near-term earning prospects</li> <li>• Unexpected changes in financial results</li> </ul>
Changes in Business and Operation	<ul style="list-style-type: none"> <li>• Any developments in resources, tech, products, or markets</li> <li>• A significant change in capital investment plans or corporate objectives</li> <li>• Labour disputes</li> <li>• Capital investment and significant new contracts.</li> <li>• Discoveries of resources</li> <li>• Significant legal proceedings</li> <li>• BD or executive management changes</li> </ul>
Acquisition and Disposition	<ul style="list-style-type: none"> <li>• Significant acquisitions or disposition of assets, property or joint venture interests</li> <li>• Acquisitions of other CO</li> </ul>
Changes in Credit Arrangement	<ul style="list-style-type: none"> <li>• Borrowing or lending money.</li> <li>• Mortgaging on company's assets</li> <li>• Changes in rating agency decisions</li> </ul>

#### PART VI: BEST DISCLOSURE PRACTICES

- Establishing a Corporate Disclosure Policy
  - There are some practical measures that COs can adopt to help ensure good disclosure practices. The consistent application of “best practices” in the disclosure of material information will enhance a CO’s credibility with analysts

## 463.4 CONTINUOUS AND TIMELY DISCLOSURE

and investors, contribute to the fairness and efficiency of the capital markets and investor confidence in those markets, and minimize the risk of non-compliance with securities legislation.

- The measures recommended here are not intended to be prescriptive. They should be implemented flexibly and sensibly to fit the situation of each individual CO.
- Overseeing and Coordinating Disclosure:
  - Establish a committee of CO personnel or assign a senior officer to be responsible for:
    - Developing and implementing your disclosure policy;
    - Monitoring the effectiveness of and compliance with your disclosure policy;
- Board and Audit Committee Review of Certain Disclosure:
  - Have BD or audit committee review the following disclosures in advance of their public release by the company:
    - Financial outlooks and FOFI, as defined in NI 51-102 Continuous Disclosure Obligations;
    - News releases containing financial information based on a CO's financial statements;
- Recommended Disclosure Model:
  - Consider using the following disclosure model when making a planned disclosure of material corporate information, such as a scheduled earnings release:
    - Issue a news release containing the information through a widely circulated news or wire service;
    - Provide advance public notice by news release of the date and time of a conference call to discuss the information, the subject matter of the call and the means for accessing it;
    - Hold the conference call in an open manner, permitting investors and others to listen either by telephone or through Internet webcasting; and
    - Provide dial-in and/or web replay or make transcripts of the call available for a reasonable period of time after the analyst conference call.
- Analyst Reports: Establish a policy for reviewing analyst reports. There is a serious risk of violating the tipping prohibition if you express comfort with or provide guidance on an analyst's report, earnings model or earnings estimates.
- Quiet Periods: Observe a quarterly quiet period, during which no earnings guidance or comments with respect to the current quarter's operations or expected results will be provided to analysts, investors or other market professionals. The quiet period should run between the end of the quarter and the release of a quarterly earnings announcement.
- Insider Trading Policies and Blackout Periods: Adopt an insider trading policy that provides for a senior officer to approve and monitor the trading activity of all insiders, officers, and senior employees. The insider trading policy should prohibit purchases and sales at any time by insiders and employees who are in possession of material nonpublic information. The policy should also provide for trading "blackout periods" when trading by insiders, officers and employees may typically not take place.
- Chat Rooms, Bulletin Boards and e-mails: Do not participate in, host or link to chat rooms or bulletin boards.
- Handling Rumours: Adopt a "no comment" policy with respect to market rumours and make sure that the policy is applied consistently.

### **SUPERINTENDENT OF BROKERS V. PEZIM, PAGE, AND IVANY [1994] SCC**

***The duty on senior officers to disclose material change within ten days includes a duty for senior management to keep informed of material info that exists so it can be disclosed as soon as practicable.***

**Facts:** Ds were directors and officers of Prime, a CO holding several wholly owned subsidiaries and controlling or managing about 50 public junior resource COs. Ds were also directors of Calpine, a CO controlled and managed by Prime. Both COs were reporting issuers listed on the VSE and subject to the VSE's rules and policies concerning public disclosure of information and pricing of options. Both were subject to the continuing and timely disclosure requirements under s.67 (which must have been the old s.85) of the *BCSA* and to the insider trading provisions under s.68. In 1990, BC Superintendent of Brokers alleged that the Ds had violated the timely disclosure provisions and insider trading provisions in three categories of impugned transactions: the drilling results and share options transactions, the private placement, and the ALC withdrawal. In the first category, Prime or Calpine failed to disclose all material changes in four transactions in that assay results were publicly disclosed after the CO had granted or repriced options. Prime was alleged to have violated s.67 by not making timely and adequate disclosure of the dispute following ALC's withdrawal. BCSecCom concluded that the respondents contravened s.67 of the *BCSA* by failing to disclose material changes in their affairs. D's' appeal was limited to whether the BCSecCom had erred as a matter of law in its conclusions on s.67 (disclosure of material change). BCCA allowed the appeal and set aside the BCSecCom's orders.

**Issue:** What is the definition of "as soon as practicable"?

#### **Discussion:**

- Old s.67 used to read: "Where a material change occurs in the affairs of a reporting issuer, the reporting issuer shall (a) as soon as practicable issue and file a press release that is authorized by a senior officer and that discloses the nature and substance of the change, and ... "

## 463.4 CONTINUOUS AND TIMELY DISCLOSURE

- BCSecCom ruled that:
  - The accumulation of drilling results for release at periodic intervals is, in most circumstances, a reasonable approach to the disclosure of such information. Where an issuer proposes to engage in a securities transaction, however, it must ensure that any undisclosed material change is disclosed before proceeding with the transaction. The words "as soon as practicable" have a different meaning in this context than they might in the absence of the securities transaction.
  - There was a positive obligation on the managers to make inquiries to determine whether there had been a material change prior to engaging in any securities transactions.
- BCCA disagrees. But what the shit do they know.
- At SCC, this case turned partly on the definition of "material change". Three elements emerge from that definition.
  - The change must be in relation to the affairs of an issuer;
  - The change must be in the business, operations, assets or ownership of the issuer;
  - The change must be "material", as defined in the *BCSA*
- "Material change" should be distinguished from that of "material fact". Undisclosed material facts concerning a reporting issuer may not require timely disclosure, but they do restrict trading, as trading on undisclosed info is insider trading.
- The meaning of "as soon as practicable" will not always be 10 days. If there is a transaction contemplated, then the change has to be disclosed prior to the transaction.
- Not all changes are material changes. Material are set in the context of making sure that issuers keep investors up to date.
- The determination of what information should be disclosed is an issue which goes to the heart of the regulatory expertise and mandate of the SecCom, that is regulating the securities markets in the public's interest.
- Officers and directors cannot make themselves willfully blind to what is going on in the CO.
- Although a duty to inquire is not expressly stated in s.67, such an interpretation contextualizes the general obligation to disclose material changes and guarantees the fairness of the market, which is the underlying goal of the *Act*.
- Material change is narrower than material fact, since it is concerned with "business, operations, or capital of the issuer", and not the broader political or economic changes around.
- Courts on appeal should give considerable deference to SecComs

**Ruling:** Appeal allowed.

### **RE PACIFICA PAPERS INC. [2001] BCSC**

***Even if a transaction would be material change, entering into a lockup agreement for it is not a material change.***

**Facts:** Pacifica and Norske, two large public COs, entered into an arrangement agreement whereby Norske agreed to acquire Pacifica. The 7-member Pacifica BD was divided during the negotiations of this transaction. It was negotiated by Johnstone, the chairman of the BD. He consulted with four other directors when he negotiated the transaction. The six board members who could vote on the transaction approved it five to one. Pacifica arranged support agreements between Norske and 10 of its larger SHs whereby the SH committed to give proxies to vote in favour of the agreement. The transaction was approved by 73 per cent of Pacifica's SHs. This application for approval was opposed by Cerberus who was a major SHs of Pacifica who was not included in support negotiations. Inter alia, it alleged that there was insufficient disclosure of the directors's dissent and that support agreements were solicited illegally and this invalidated the shareholders' vote, as there was no disclosure of the support agreements in the proxies.

**Issue:** Should this have been disclosed?

#### **Discussion:**

- The circular set out the negotiations that occurred between Pacifica and both offering COs and did not fail to disclose any more favourable offer.
- The circular contained sufficient detail for a SH to form a conclusion on whether sufficient consideration was given to the competing offer.
- The board reported to the SHs as a single unit by way of the circular and it was not necessary to include the views of dissenting directors. The circular contained sufficient information to inform the SHs that there was some dispute among the directors.
- Despite the dissent and the lock-up agreement, nothing is guaranteed until vote happens. Thus no material change occurred.
- Ditto for proxies, which are revocable until the actual vote.

**Ruling:** Application allowed.

## EXEMPT MARKET

- The general rule is that no sale of securities to the public is to be done without a prospectus.
- But what fun would it be if there were no exceptions to this? So we have the exempt market, which allows sale of securities to the public without incurring a full prospectus-level disclosure.
- In BC, 80% of market activity happens in exempt market.
- Any issuer (even those that have not filed a prospectus) can distribute securities in the exempt market under NI 45-106. This is considered to be the primary exempt market.
  - Reporting issuers that have sold public issues under a prospectus can also do transactions in the exempt market.
- All those exempt purchasers can re-sell to each other or anyone within the exempt market.
- Its only if these investors want to sell outside of the bubble that the sale is deemed a “distribution” and they will either have to:
  - Get the issuer to provide a prospectus under s.61 of *BCSA*.
  - Through resale rules NI 45-102
  - Via the transactional category exemption for things such as rights offering, even if the offeree SHs are outside of the exempt market.

**Rights Offering:** A way for a CO to raise capital under a secondary market offering. The rights offering is a special form of shelf offering or shelf registration. With the issued rights, existing SHs have the privilege to buy a specified number of new shares from the CO at a specified price within a specified time. Closed-end COs cannot retain earnings, because they distribute essentially all of their realized income, and capital gains each year. They raise additional capital by rights offerings. CO usually opt for a rights issue either when having problems raising capital through traditional means or to avoid interest charges on loans.

**AIM Market:** AIM is a sub-market of the London Stock Exchange, allowing smaller companies to float shares with a more flexible regulatory system than is applicable to the main market. AIM provides principles-based rules based on a comply-or-explain option that lets COs either comply with AIMs relatively few rules, or explain why it has decided not to comply with them. So it's sort of like an exempt market, in that a CO can float there with no prospectus.

**Nominated Adviser (Nomad):** Nomad is a CO which has been approved by the LSE as a nominated adviser for the AIM. The Nomad project manages the admission of new issues to AIM and also acts as the effective regulator. Typically the NOMAD is a firm of investment bankers with experience of bringing companies to the market.

## PRIMARY MARKET: EXEMPTION FROM PROSPECTUS REQUIREMENT

### POLICY

Theory for having an exempt market is based on a number of considerations:

- Sometimes the cost and time of issuing a prospectus would exceed the benefit to the public.
- Some transactions don't present the same risk to investors, and one should be able to do them quickly and cheaply.
- Large COs have enough information about them in the market thanks to analysts and stock-watchers.
- Also, there are some investors who sophisticated and risk-resistant enough to operate on reduced information.

### EXEMPT PURCHASERS

There are categories of purchasers who are deemed sufficiently protected due to their experience, sophistication, and statute.

- Sophisticated investors:
  - Because of high degree of investment expertise these can determine the information that they need: they know where to find it and how to assess it.
  - They have practical experience and legal advice to safeguard
  - Includes: banks, insurance COs, government, pension funds, mutual funds, investment and securities COs.
- Large purchasers:
  - These have more incentive and means to gather information and assess the value of securities.
  - Due to their large investments they can demand information by pressuring the CO.
- Wealthy investors:
  - These are not necessarily sophisticated, but are more likely to have investment portfolios and so investment knowledge
  - Also they are better position to bear a loss. As in the SecComs don't care about the rich.



## 463.5 EXEMPT MARKET

- Common Bonds purchasers:
  - These are family members, friends, insiders, directors and officers, controlling shareholder, etc.
  - It is postulated that close bond makes it more likely they know or can get the information needed.
  - Also one would assume that they are less likely to be taken advantage of.

**Need to Know Test:** Met when persons have access to the kind of information that would normally be disclosed in an offering document or when persons have a certain amount of sophistication about making investment decisions enabling them to fend for themselves. This applies to insiders, directors and officers, controlling SHs, etc.

**Common Bonds Test:** Focuses on the relationship between the seller of the securities and the persons to whom the securities are being offered. This applies to friends, family, etc.

### NO NEW INFORMATION EXCEPTION

In the cases where there is no new information on the securities, the cost of prospectus disclosure is not justified.

- Rights offering:
  - SHs were already provided the information at the original time of purchase - either via a prospectus, or because they fit under one of the exceptions.
  - But there may be need to provide new info, for example the use of proceeds from rights offering. Thus this exemption may be qualified by the requirement to issue some information.
- Stock dividends re-investment:
  - Plans are offered to SHs to allow them to direct cash dividends or interest to be reinvested in securities of the issuer
  - If the dividends are received from shares originally under prospectus, then there is no need for a new one.
  - There is no additional capital put in by investor, thus no increase in risk of loss.
- Takeover bids and amalgamations:
  - Info on takeover bids would be provided in takeover bid circular, so there is no need to duplicate this disclosure in a prospectus.
  - For amalgamation, corporate law requires SH approval based on disclosure in a proxy circular.

### EXEMPT ISSUERS

- Small closely held COs:
  - The number of investors and small monetary value of the CO.
  - The issue is usually one time trade to one or two investors
  - Regulatory cost of going to market is otherwise too prohibitive
- Entities regulated under another regulatory regime:
  - Such as banks, other financial institutions and such.
- Well-seasoned issuers:
  - Have lots of information about them in the market because of continuous disclosure requirements.
  - This exception has been largely delegated to short-form prospectuses.
- Charities, religious, educational groups:
  - One would assume that these are not going to fuck anyone over. Little do they know...
- Bonds of national, state or provincial governments have low default risk because government usually has a tax base on which it can raise revenue to meet the bond payment obligations. Or if they are in the EU they will get bailed out by Germany.
- Ditto for RRSPs

### NI 45-106 PROSPECTUS AND REGISTRATION EXEMPTIONS

This covers capital raising exemptions, private placements, transaction exemptions, and some others.

**Accredited Investor:** Includes the following:

- (a) a Canadian financial institution, or a Schedule III bank, or a subsidiary of such;
- (b) a person registered under the securities legislation of a jurisdiction of Canada as an adviser or dealer. Such must have a designated partner, director or officer, who has passed certain courses dealing with securities and have specified amount of previous experience in the business.
- (c) investment bank, mutual fund, or a pension fund;
- (d) ...

- (j) an individual who, either alone or with a spouse, beneficially owns financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds \$1 000 000,
- (k) an individual whose net income before taxes exceeded \$200 000 in each of the 2 most recent calendar years or whose net income before taxes combined with that of a spouse exceeded \$300 000 in each of the 2 most recent calendar years and who, in either case, reasonably expects to exceed that net income level in the current calendar year
- (l) an individual who, either alone or with a spouse, has net assets of at least \$5 000 000,
- (m) trust COs and such
- (n) registered charities that have obtained advice
- (o) a person that is recognized or designated by the securities regulatory authority or, except in ON and QB, the regulator as an accredited investor;

**Eligible Investor:** A wider and looser category which includes the following:

- (a) a person whose
  - (i) net assets, alone or with a spouse, in the case of an individual, exceed \$400 000,
  - (ii) net income before taxes exceeded \$75 000 in each of the 2 most recent calendar years and who reasonably expects to exceed that income level in the current calendar year, or
  - (iii) net income before taxes, alone or with a spouse, in the case of an individual, exceeded \$125 000 in each of the 2 most recent calendar years and who reasonably expects to exceed that income level in the current calendar year,
- (b) a CO of which a majority of the voting SHs are eligible investors or a majority of the directors are eligible investors,
- (c) a GP or LP of which all of the partners are eligible investors,
- (d) an accredited investor,
- (e) a person described in section 2.5 [Family, friends and business associates], or
- (f) a person that has obtained advice regarding the suitability of the investment and, if the person is resident in a jurisdiction of Canada, that advice has been obtained from an eligibility adviser;

## PART 2, DIVISION 1: CAPITAL RAISING EXEMPTIONS

### 2.1 Rights Offering

- Issuer generally doesn't need to file prospectus for distribution of rights to existing SHs.
- But in case there is some info relevant to the investor, there is a requirement for written notice sent to a regulator, outlining date, amount, nature, conditions of trade, net proceeds, etc. to which the regulator has 10 days to object.
- The issuer has to be in compliance with the NI 45-101 Rights Offerings.
- For resale refer to App. E of NI 45-102.

### 2.2 Reinvestment Plans

- Issuer doesn't need to file prospectus if the distribution is under a reinvestment plan, such as a dividend in the form of a security.
- But the securities distributed thus cannot exceed 2% of issued and outstanding shares of the class per year.
- And such plan has to be available to every SH to whom a dividend is available.
- For resale refer to App. E of NI 45-102.

### 2.3 Accredited Investor

- The prospectus requirement does not apply to a distribution of a security if the purchaser purchases the security as principal and is an accredited investor, which requires a degree of financial sophistication.
- Applies only if purchasing as principal. So one can sell to CIBC as exempt purchaser, but not if CIBC is just acting as agent for other non-accredited investors. Thus no back-door underwriting gets through.
- Purchasers are subject to both seasoning and holding periods.
- For resale refer to App. D of NI 45-102.

### 2.4 Private Issuers

- The prospectus requirement does not apply to a distribution of a security of a private issuer to a person who purchases the security as principal, and is a:
  - Director, officer, employee, founder, control person of the issuer or affiliate, or spouse/family member of such
  - A close personal friend or a close business associate of a director, executive officer, founder or control person of the issuer;
  - A SH of the issuer;
  - An accredited investor;
  - Person that is not the public. Essentially, you can solicit from an individual person, but can't offer to general public.
- For this section, an issuer is a private issuer if:

- It is not a reporting issuer
- The securities are beneficially owned by no more than 50 persons
- The securities will have a legend (are subject to restrictions on transfer)
- And their securities will be distributed only to exempt purchasers who buy as principal
- For resale refer to App. E of NI 45-102.

### **2.5 Family, Friends and Business Associates**

- Except in ON and SK the prospectus requirement does not apply to a distribution of a security to a person who purchases the security as principal and is
  - A director, executive officer or control person of the issuer, or of an affiliate of the issuer;
  - Their family (spouse, parents, grandparents, kids), close friends and close business associates;
- For ON look at 2.7
- For resale refer to App. D of NI 45-102.

### **2.8 Affiliates**

- The prospectus requirement does not apply to a distribution by an issuer of a security to an affiliate of the issuer that is purchasing as principal.
- Wouldn't take advantage, or have a remedy under breach of fiduciary duty
- For resale refer to App. D of NI 45-102.

### **2.9 Offering Memorandum**

- The prospectus requirement does not apply to a distribution by an issuer of a security to a purchaser if there the distribution is accompanied by an offering memorandum, and the purchaser signs an acknowledgement of risk.
- In some jurisdictions outside of BC, the purchaser also has to be an eligible investor.
- For resale refer to App. D of NI 45-102.

**Offering Memorandum:** Slim disclosure document that contains a disclaimer and a signed acknowledgment of risk. It is not filed with or vetted by the regulator, send it to investors. It states that it doesn't contain misrepresentations, and is signed by CEO and CFO, two directors, and a promoter. These are most useful for small local and highly risky COs, usually in mining and exploration business. Note that there is a civil liability for misrepresentation in this document under s.132.1.

### **2.10 Minimum Amount Investment**

- The prospectus requirement does not apply to a distribution of a security to one person if the security has an acquisition cost to the purchaser of not less than \$150 000 paid in cash at the time of the distribution.
- Multiple investors can't pool small investors together to meet this threshold, and a CO made for the purpose of this will be seen as a sham.
- For resale refer to App. D of NI 45-102.

## PART 2, DIVISION 2: TRANSACTION EXEMPTIONS

### **2.11 Business combination and reorganization**

- The prospectus requirement does not apply to a distribution of a security in connection with an amalgamation, merger, reorganization or arrangement that is under a statutory procedure.
- It is assumed that the information necessary would come in an information circular or similar disclosure document that is provided.
- Plus the transaction is subject to SH approval anyways.
- For resale refer to App. E of NI 45-102.

### **2.12 Asset Acquisition**

- The prospectus requirement does not apply to a distribution by an issuer of a security to a person as consideration for the acquisition, directly or indirectly, of the assets of the person, if those assets have a fair value of not less than \$150 000.
- For resale refer to App. D of NI 45-102.

### **2.14 Securities for Debt**

- The prospectus requirement does not apply to a distribution by a reporting issuer of a security of its own issue to a creditor to settle a bona fide debt of that reporting issuer.
- For resale refer to App. D of NI 45-102.

## 2.16 Takeover Bids and Issuer Bids

- The prospectus requirement does not apply to a distribution of a security in connection with a take-over bid in a jurisdiction of Canada or an issuer bid in a jurisdiction of Canada.
- Since the takeover bid circular has to include prospectus level disclosure, where securities are offered in a bid, it is treated as prospectus.

## PART 2, DIVISION 4: EMPLOYEE, EXECUTIVE OFFICER, DIRECTOR AND CONSULTANT EXEMPTIONS

### 2.24 Employee, executive officer, director and consultant

- Subject to s.2.25, the prospectus requirement does not apply to a distribution by an issuer in a security of its own issue, or by a control person of an issuer of a security of the issuer or of an option to acquire a security of the issuer, to an employee, executive officer, director or consultant of the issuer, (or of related entity of the issuer) if participation in the distribution is voluntary.
- For resale refer to App. E of NI 45-102.

### 2.26 Distributions among current or former employees, executive officers, directors, or consultants of non-reporting issuer

- The prospectus requirement does not apply to a distribution of a security of a non-reporting issuer by a current or former employee, executive officer, director, or consultant of the issuer or related entity of the issuer to an employee, executive officer, director, or consultant of the issuer or a related entity of the issuer.
- For resale refer to App. E of NI 45-102.

### 2.35 Short Term Debt

- The prospectus requirement does not apply to a distribution of a negotiable promissory note or commercial paper maturing not more than one year from the date of issue.
- This is free trading.

## PART 4: CONTROL BLOCK DISTRIBUTIONS

**Control Block Distribution:** Means a trade which is a trade in a previously issued security of an issuer from the holdings of a control person as defined in *BCSA*.

- Under NI 45-102 s.2.8, control person is one with 20% beneficial ownership.
- If such sells to another control person in the course of a takeover bid, then the transaction is exempt from prospectus requirement if meet these conditions:
  - Seasoning period. The issuer has been a reporting issuer for at least 4 month, and the control person must have held for at least 4 month
  - There have been no extraordinary efforts to sell or commission or consideration;
  - Seller must have no reasonable grounds for thinking issuer in default; and must give 7 days advance notice of intention to sell, via insider report on SEDI.
- If control person sells to anyone other than another control person, then a prospectus must be issued. Unless meet the exemption in NI 45-106 Part IV Control Block Distribution:
  - Control person has to be an Eligible Institutional Investor and file reports under the Early Warning System (NI 62-103);
  - He must not be trading on inside info;
  - He must not possess effective control of issuer (either alone or joint & in concert).
  - No unusual efforts, or commission, or consideration is present
  - And a letter is filed to SecCom 10 days after the distribution.

## BCSA PART 10 EXEMPTIONS FROM PROSPECTUS REQUIREMENTS

### 76 Exemption order by commission or executive director

- (1) *If the commission or the executive director considers that to do so would not be prejudicial to the public interest, the commission or the executive director may order that*
- a trade, intended trade, security or person or class of trades, intended trades, securities or persons is exempt from one or more of the requirements of Part 9 or the regulations related to Part 9, and*
  - a trade or intended trade or class of trades or intended trades is deemed to be a distribution.*

- (2) *An order under subsection (1) may be made on application by an interested person or on the commission's or the executive director's own motion.*
- (3) *On application of an interested person, the commission or the executive director may determine whether the distribution of a security has been concluded or is currently in progress.*

### SECONDARY MARKET: RE-SALE OUTSIDE OF EXEMPT MARKET

- The purchaser of securities under NI 45-106 can re-sell those exempt securities to anyone who is within the exempt market bubble.
- But when they want to re-sell their exempt securities outside of the exempt market bubble to the public, the re-sale is deemed “distribution” and so subject to prospectus requirement.

### NI 45-102 RESALE OF SECURITIES

- Note that these only apply to the securities of a reporting issuer.

#### **2.3 Section 2.5 Applies**

- If a security was distributed under any of the provisions listed in Appendix D, the first trade of that security is subject to section 2.5.
- This is the standard default section that applies most of the time.
- This applies to the following:
  - Accredited Investors
  - Family, Friends and Business Associates
  - Affiliates
  - Offering Memorandum
  - Minim Amount Investment
  - Business Asset Acquisition

#### **2.4 Section 2.6 Applies**

- If a security was distributed under any of the provisions listed in Appendix E, the first trade of that security is subject to section 2.6.
- This applies to the following
  - Rights Offering
  - Reinvestment Plans
  - Private Issuers
  - Business combination and reorganization
  - Take-over bids and Issuer Bids
  - Employee, executive officer, director and consultant

#### **2.5 Restricted Period**

- To not be deemed a “distribution”, the resale has to meet all of the following conditions:
  - Seasoning Period
    - The issuer is a reporting issuer and has been for 4 months before the trade
    - Then all sorts of info will be available to the public via continuous disclosure;
  - Hold Period
    - A period of at least 4 months has elapsed since the date of issuer's exempt distribution;
    - This is to avoid “backdoor underwriting” (so that one can't buy under exemption and shortly after sell to non-exempt as a way of by-passing prospectus process);
  - Legend
    - The security certificate of ownership stmt must bear a legend setting out the hold period
    - This assures that hold period is satisfied
- Not a re-sale to public by a control person, to which separate rules apply under “Control Block Exemption”
- No extraordinary or unusual effort to sell must be present;
- No extraordinary commission or consideration
- Trade should be on the basis of information already disclosed, not on basis of private individual's biased representations
- This discourages promotional campaigns that pressure investors and make representations other than in statutorily required docs
- They must have no reasonable grounds to think the issuer is in default of securities legislation

### **2.6 Seasoning Period**

- This is applied largely to the transactional exemptions.
- To not be deemed a “distribution”, the resale has to meet all of the following conditions:
  - These are the same as above minus the Hold Period and the Legend.
  - The has been a reporting issuer in a jurisdiction of Canada for the 4 months immediately preceding the trade.
  - The trade is not a control distribution.
  - No unusual effort is made to prepare the market or to create a demand for the security that is the subject of the trade.
  - No extraordinary commission or consideration is paid to a person or company in respect of the trade.
  - If the selling security holder is an insider or officer of the issuer, the selling security holder has no reasonable grounds to believe that the issuer is in default of securities legislation.

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

- A sale by a control person must meet the following to not be deemed a distribution:
  - The has been a reporting issuer in a jurisdiction of Canada for the 4 months immediately preceding the trade.
  - The selling security holder has held the securities for at least 4 months.
  - No unusual effort is made to prepare the market or to create a demand for the security that is the subject of the trade.
  - No extraordinary commission or consideration is paid to a person or company in respect of the trade.
  - The selling security holder has no reasonable grounds to believe that the issuer is in default of securities legislation.

### **2.14 First Trades in Securities of a Non-Reporting Issuer Distributed under a Prospectus Exemption**

- The prospectus requirement does not apply to the first trade of a security distributed under an exemption from the prospectus requirement if
  - The issuer is a non-reporting issuer
  - At the distribution date residents of Canada did not own directly or indirectly more than 10% of the outstanding securities of the class or series, and
  - The trade is made through an exchange, or a market, outside of Canada, or to a person or CO outside of Canada.

### **3.1 Exemption**

- The regulator or the securities regulatory authority may grant an exemption from this Instrument, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

## INSIDER TRADING

The prohibition of insider trading is based on the principle of symmetrical info in the market to allow all investors to have all relevant and equal information to make investment decisions.

- This needs timely and non-selective disclosure, as lack of such would give material advantage to some parties.

**Affiliate:** an issuer is affiliated with another issuer if:

- One of them is the subsidiary of the other (that is controls more than 20% of voting securities), or
- Each of them is controlled by the same person.

**Associate:** Means, if used to indicate a relationship with any person,

- A partner, other than a limited partner, of that person,
- An issuer of whom the person controls, directly or indirectly, voting securities carrying more than 10%
- 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;

**Insider:** Means

- A director or an officer of an issuer, or of a person that is itself an insider or a subsidiary of an issuer,
- A person that has or control or direction over, directly or indirectly, of securities of an issuer carrying more than 10%
  - This can lead to “daisy chains” where insider of an insider will be deemed insider to the third party.
- An issuer that has purchased, redeemed or otherwise acquired a security of its own issue.

**Special Relationship:** For the purposes of ss.57.2 and 136, as defined in s.3 of *BCSA* this is:

- Insider, affiliate, or associate of the issuer, the offeror, or anyone proposing to acquire a substantial asset of the issuer.
  - Someone who is engaging or proposing to engage in a business or professional activity on behalf of the above: lawyers, agents, etc.
- Someone who knows of a material fact or of a material change with respect to the issuer, having acquired it through the special relationship described above.
- Someone who knows of a material fact or of a material change with respect to the issuer, having acquired it from another person, who himself was in a special relationship, as long as he knew or ought to have known of this.
  - These can be mixed and matched with the definition of “insider” to create some tricky combinations.
  - Family members are not caught, except for (e), and the associates sneaking in through (a)
  - Another danger is the daisy chain effect based on the 10% ownership

## BCSA PART 7

- Whereas 57.2 covers those who are privy of the material information because of their relationship to the issuer, 57.3 applies to those privy to the information because of their relationship to the would be investor.
- Each section is split into trading a security, tipping another about the material information, and basic recommending to trade the security without necessarily disclosing the material information.

**57.2 Insider trading, tipping and recommending**

(2) A person must not enter into a transaction involving a security of an issuer, or a related financial instrument ... , if the person

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

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

(3) An issuer or a person in a special relationship with an issuer must not inform another person of a material fact or material change ... unless

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

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

(4) A person who proposes to

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

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

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

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

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

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

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

**57.3 Front running**

- (2) For the purposes of this section, a person is connected to an investor if the person
- is an insider, affiliate or associate of the investor,
  - is an investment fund manager of the investor,
  - is engaging or proposes to engage in a trading or advising relationship with or on behalf of the investor ...
  - is a director, officer or employee of the investor or of a person described in paragraph (a), (b) or (c),
  - knows of material order information relating to the investor, having acquired the knowledge while in a relationship described in paragraph (a), (b), (c) or (d), or
  - knows of material order information relating to the investor, having acquired the knowledge from another person at a time when
    - that other person was connected to the investor, whether under this paragraph or any of paragraphs (a) to (e), and
    - the person that acquired knowledge of the material order information from that other person knew or reasonably ought to have known of the connection referred to in subparagraph (i).
- (3) A person that is connected to an investor and knows of material order information relating to the investor must not enter into a transaction involving
- a security or an exchange contract that is the subject of the material order information, or
  - a related financial instrument of a security or an exchange contract referred to in paragraph (a).
- (4) A person that is connected to an investor must not inform another person of material order information relating to the investor unless it is necessary in the course of the business of the person or the investor.
- (5) A person that is connected to an investor and knows of material order information relating to the investor must not recommend or encourage another person to enter into a transaction involving
- a security or an exchange contract that is the subject of the material order information, or
  - a related financial instrument of a security or an exchange contract referred to in paragraph (a).

**Material Order Information:** Information that relates to the intention of an investor to purchase or trade a security or an exchange contract, if the execution of one or more orders, the placement of one or more orders to carry out the intention, or the disclosure of any of the information, would reasonably be expected to significantly affect the market price of the security or the exchange contract;

**Necessary Course of Business:** This is defined in NP 51-201 3.3 on page 26.

**Generally Disclosed:** This is defined in NP 51-201 3.4 on page 26.

**57.4 Defences**

- (1) A person does not contravene [entering into transaction] if, at the time the person enters into the transaction involving the security ... the person reasonably believes that the other party to the transaction knows of the material fact, material change or material order information.
- (2) A person does not contravene [tipping] if, at the time the person informs the other person of the material fact, material change or material order information, the person reasonably believes that the other person knows of the material fact, material change or material order information.
- (3) A person does not contravene [entering into transaction] if the person
- enters into the transaction as a result of a written legal obligation
    - imposed on the person, or
    - that the person entered into before obtaining knowledge of the material fact, material change or material order information.
  - ...
- (5) A [Company] does not contravene [entering into transaction or recommending] if no individual involved in making the decision to enter into the transaction or make the recommendation on behalf of the Company
- has knowledge of the material fact, material change or material order information, and
  - is acting on the recommendation or encouragement of an individual who has that information.
- (6) A person does not contravene [s.57.3 prohibitions] if, at the time the person
- enters into the transaction involving the security, exchange contract or related financial instrument,
  - informs another person of the material order information, or
  - recommends or encourages another person to enter into a transaction,
- the person reasonably believes that the investor has consented to the person entering into the transaction or informing, recommending or encouraging.

**87 Insider reports**

- (2) An insider of a reporting issuer must, in accordance with the regulations,
- file reports disclosing the insider's
    - beneficial ownership of, or control or direction over, directly or indirectly, securities of the issuer, and
    - interest in, or right or obligation associated with, a related financial instrument of a security of the issuer, and
  - make other prescribed disclosure.



## NI 55-104 INSIDER REPORTING REQUIREMENTS AND EXEMPTIONS

- This covers the process through which insiders can trade their securities.
- There is a whole lot here that is not on the exam and someone else can read if they really feel like it.

**R. v. R.BENNETT, H.DOMAN, AND W.BENNETT [1989] BC PC**

***The criminal burden of proof is applicable in persecuting insider trading, and is very hard to meet.***

**Facts:** Doman was the president of DIL, a BC forestry firm, which was a target of a proposed takeover by LP, a large US forest firm. The takeover bid was rumored for a few month prior to being made public in September 1988. At the beginning of this period, the price of DL shares was close to \$5. Over the next three months, the price went up to \$11.50, rising towards the \$12 per share proposed bid. Other two Ds were a friend of Doman, and the friend's brother, and all three had substantial amount of borrowed money invested in the CO. On November 4th, LP made a private call to Doman and told him that the bid was cancelled. Three minutes later, there was a phone call outgoing from his office. Half an hour later, all of Ds have sold their shares. Next day the information of the failed bid went public and the share price plummeted. Crown accused D's of tipping and insider trading.

**Issue:** Is there enough evidence to prove this?

**Discussion:**

- Crown has no direct evidence that tipping occurred
- But they claim that the circumstantial evidence is such, that the only reasonable inference is the guilt of the Ds
- To establish the guilt, the standard is BARD
- D B.Bennett has never met D Doman, and has in fact tried selling his shares on November 1, three days prior to the ending of the bid. The order was not filled, but his broker had instructions to sell.
- D. R.Bennett was friends with D Doman, but not engaged in business. The two were avid fans of horse racing. Bennett has also seriously talked with his broker about selling his shares for over a week prior to the sale
- So the only thing in question is whether D. Doman did tip someone with a call right after finding out the news. There was one going out from DIL office to the Bennett office, but there are 15 phones in each office, and there is no way to prove which one phoned which.
- All of the actions of the Ds are generally consistent with the typical market behaviour.
- Though the actions, considered together, can be viewed in a sinister light, the Crown has not proved BARD that the sales were a result of tipping.

**Ruling:** All D's acquitted.

**DONNINI V. ONSECOM [2005] ONCA**

***A reviewing court must show a high level of deference to a SecCom's decision on sanctions.***

**Facts:** D was the head institutional trader for Yorkton Securities. He was involved in arranging financing for a technology CO, KCA. On February 29, D became aware that KCA and Y were negotiating a second financing which was announced publicly two days later, on March 2. The majority of the SecCom found that the proposed second financing was a material fact that D had knowledge of on February 29, and that he thereafter intentionally traded in KCA shares on a "massive scale" on February 29 and March 1, thereby violating the insider trading provisions of the *QNSA*. The Commission suspended D for 15 years and ordered him to pay \$186,000.00 in hearing and investigation costs. D appealed all aspects of the SecCom order. A panel of the Divisional Court dismissed the appeal from liability, but allowed the appeal in respect of the sanctions imposed on D and the award of costs. The Court reduced D's suspension from 15 to 4 years and directed the SecCom to reconsider its costs award by following specific procedural steps. SecCom appealed.

**Issue:** Has SecCom overstepped its boundaries?

**Discussion:**

- Divisional Court did not err by upholding the finding that D was guilty of insider trading. There was ample evidence to support this conclusion.
- The standard of review to be applied to the decisions of the SecCom was reasonableness
- The Divisional Court did not refer to the reasoning of the SecCom but impermissibly substituted its own view of the evidence for that of the SecCom.
- SecCom took into account the appropriate factors in imposing severe sanction on D, including his senior position at Y, his experience in the industry, his other misconduct in the market and the devastating impact insider trading can have on the integrity of the market and on investor confidence.
- Thus, SecCom's appeal on this issue was allowed, and the court restored D's 15-year suspension.

**Ruling:** Shitty.

**R. v. FINGOLD [1999] ONCJ*****Something about honest reasonable belief that information is not material?***

**Facts:** Fingold was a director of Cineplex. Fobasco was a holding CO which was owned in equal shares by D and his brother. Slater was owned by Fobasco. Fobasco and Slater purchased shares in C. D purchased shares in Cineplex for his personal account. A meeting of the board of C was held on February 25, 1989, at which the 1988 financial results were disclosed. The results showed losses in the film exhibition business. D tendered his resignation as director to be effective February 28, 1989. Subsequently, Slater and Fobasco sold shares in C. On March 22, 1989, the day on which the 1988 financial results were released, D sold his shares in Fobasco. On November 1, 1991, the SecCom investigator examined Drabinsky, who was a principal of C, regarding the sale of shares. Drabinsky revealed that D had engaged in insider trading. The information was sworn on January 19, 1993. The charge was dismissed on the grounds that the information was laid outside the one year limitation period and the accused had a defence on the merits. SecCom argued that the trial judge erred in finding that the facts upon which the proceedings were based were known to the SecCom on November 1, 1991. D claimed to have had no knowledge. D was acquitted and SecCom appealed.

**Issue:** What happened?**Discussion:**

- The trial judge had not erred in finding that the facts upon which the proceedings were based first came to the knowledge of the SecCom on November 1, 1991 and that the information sworn on January 19, 1993 was out of time.
- The trial judge was correct in finding that D was the operating mind and person authorized to deal in C shares with respect to Fobasco and Slater.
- The trial judge found that D had reason to believe that his knowledge of the 1988 year end results was not a material fact and that he could sell his shares without ONSA.
- Deference had to be shown to the trial judge's findings unless he had misapprehended the evidence.
- The trial judge had not erred in acquitting the accused on the merits.

**Ruling:** Appeal dismissed.**R. v. HARPER [2000] ONCJ*****Insider Trading is a strict liability offence and defenses to it are either mistake of fact or due diligence, established by D on BP***

**Facts:** This was a prosecution of Harper by the ONSecCom on two counts of insider trading in shares of Golden Rule Resources, a mineral exploration CO. SecCom charged D, the President of GR and alleged that D was a person in a special relationship with GR and that he sold shares with the knowledge of a material fact or material change with respect to GR that had not been generally disclosed. The material facts of which D was alleged to have knowledge included reports on soil results which indicated much lower levels of gold in land being mined by GR than were indicated in previous reports. Those earlier reports, which showed very high levels of gold, had been released to the public, but the later ones were not. Even after the new reports were received by D, he continued to send out positive press releases and reported that there were no additional reports. GR stock prices increased. When the information was later released, the stock price fell dramatically. By the time the other reports were disclosed, D had sold most of his shares in GR. D agreed that he was in a special relationship with GR and that he had sold the shares in question. He argued that the information was not material but that if it was, he had a genuine and reasonable belief that it was not.

**Issue:** Right...**Discussion:**

- There was no doubt that D failed to disclose material facts of which he had knowledge.
- If the good news was material enough to be released, then the bad news was also material.
- It was common sense that the bad news regarding the soil results would affect the price of shares.
- The fact that disclosure of the information caused the stock price to decrease indicated clearly that the information was material to investors.
- Because the offence was a strict liability offence, D was required to prove either mistake of fact or due diligence.
- D knew the results of all of the tests and knew of their inconsistencies.
- He buried the results deliberately because they were counter to his financial interests.

**Ruling:** He's lucky he did not fall out of a helicopter.

## REGULATION OF TAKE-OVER BIDS

When it comes to take over bids, the regulators are concerned with the rights of the holders of common shares of the target CO, and any other securities (preferred shares and debt) that have a conversion right.

- Once again, the principal cause for the regulation is to protect the public interest for those involved in the market
- The primary legislative focus for the take over bid regulation is to protect the interest of the offeree CO's SHs
- In BC, these are governed by the MI 62-104, and Part 13 of the *BCSA*. In ON, this is governed by OSC Rule 62-504.

**Offeror:** The person that makes a take-over bid, an issuer bid, or an offer to acquire. Also known as the acquirer.

**Offeree:** The CO whose securities are the subject of a take-over bid, an issuer bid, or an offer to acquire.

**Take Over Bid:** Means an offer to acquire outstanding voting or equity securities of a class made to one or more persons, where the securities subject to the offer to acquire, together with the offeror's securities, constitute in the aggregate 20% or more of the outstanding securities of that class at the date of the offer.

- The offeree must be in the local jurisdiction.
- This does not include an offer to acquire if the offer to acquire is a step in an amalgamation, merger, reorganization or arrangement that requires approval in a vote of security holders.

**Issuer Bid:** An offer to acquire or redeem securities of an issuer made by the issuer to one or more persons, in the local jurisdiction. This does not include an offer where

- No valuable consideration is offered or paid by the issuer for the securities,
- The offer to acquire or redeem, is a step in an amalgamation, merger, reorganization or arrangement that requires approval in a vote of security holders, or
- The securities are debt securities that are not convertible into securities other than debt securities;

**Amalgamation:** A statutory means of combining two or more COs into a single CO.

**Arrangement:** A court approved scheme of arrangement is an agreement between a CO and either the holders of its securities or its creditors. Examples of when schemes of arrangement may be used include rescheduling debt, for TOBs, and for returns of capital. When used for a TOB, a scheme of arrangement can only be used for an friendly bid, because the application to the court must be made by the company whose shares are being re-organised; the target.

**Share Consolidation:** A share consolidation is the opposite of a share split. Each SH's shares are replaced with a smaller number of shares with a higher par value. If a shareholder has a 1,000 shares with a par value of \$10, then after a 1 for 2 consolidation the shareholder will have 500 shares with a par value of \$20.

**Greenmail:** A CO making partial bid at a high enough price with expectation that target CO would offer to buy the bidder's shares at a higher price to prevent the take-over. In Canada there is no greenmail because issuer bids have to be made generally, and an issuer cannot selectively bid to specific SHs.

**Bust-Up Take-over:** A leveraged take-over, where the bidder aims to break up and sell off parts the target CO after the acquisition to finance the debts incurred in the purchase.

**Front-Loaded Bid:** A two tier bid where the second stage is such a shitty deal, that SHs will be scared to get stuck tendering their shares into it, and will stampede to tender into the first stage, even if the first stage itself is not as appealing. This is usually seen as coercive.

Take-over bids are only triggered when SH, as a result of an offer to SHs, will hold more than 20% of equity shares.

Examples:

- X owns 9% of shares of CO. X then purchases 5%, then another 5%. This is not a TOB
- X owns 9% and enters into an agreement to buy 12% more share from the CO. This is not a TOB, as X buys the 12% from the CO, not the secondary market.
- X owns 16% of the common shares and 14% of the preferred shares. X purchases another 16% of the preferred shares. This is not a TOB, as the preferred shares are non-voting.

### BCSA PART 13: TAKE OVER BIDS AND ISSUER BIDS

#### 98 Making a bid

*A person must not make a take over bid or an issuer bid, whether alone or acting jointly or in concert with one or more persons, except in accordance with the regulations.*

#### 99 Recommendation relating to bid

*(1) When a take over bid has been made, the directors of the issuer whose securities are the subject of the take over bid must*

## 463.7 TAKE-OVER BIDS

- (a) *determine whether to recommend acceptance or rejection of the take over bid or determine not to make a recommendation, and*  
(b) *make the recommendation, or a statement that they are not making a recommendation, in accordance with the regulations.*
- (2) *An individual director or officer of the issuer whose securities are the subject of a take over bid may recommend acceptance or rejection of the take over bid if the recommendation is made in accordance with the regulations.*

### SPECIAL APPLICATIONS

**Interested Person:** For the purposes of ss.114 and 115 (application to court) this means:

- An issuer whose securities are the subject of a take over bid, issuer bid or other offer to acquire,
- A security holder, director or officer of an issuer referred to above,
- An offeror,
- The executive director of SecCom, and
- Any person not referred to above who, in the opinion of the SecCom or the SC, is a proper person to make an application under ss.114 or 115;

### **114 Applications to the commission**

- (1) *On application by an interested person, if the commission considers that a person has not complied or is not complying with a requirement under this Part, the commission may make an order*
- (a) *restraining the distribution of any record used or issued in connection with a take over bid or an issuer bid,*
  - (b) *requiring an amendment to or variation of any record used or issued in connection with a take over bid or an issuer bid and requiring the distribution of amended, varied or corrected information,*
  - (c) *directing any person to comply with a requirement under this Part,*
  - (d) *restraining any person from contravening a requirement under this Part, or*
  - (e) *directing the directors and officers of any person to cause the person to comply with or to cease contravening a requirement under this Part.*
- (2) *On application by an interested person or on the commission's own motion, the commission may order that a person is exempt from any requirement under this Part or the regulations relating to this Part if the commission considers that it would not be prejudicial to the public interest to do so.*

### **115 Applications to the court**

- (1) *On application by an interested person, if the Supreme Court is satisfied that a person has not complied with a requirement under this Part, the Supreme Court may make whatever interim or final order the Supreme Court thinks fit, including, without limitation, an order*
- (a) *compensating any interested person who is a party to the application for damages suffered as a result of a contravention of a requirement of this Part or the regulations,*
  - (b) *rescinding a transaction with any interested person, including the issue of a security or an acquisition and sale of a security,*
  - (c) *requiring any person to dispose of any securities acquired in connection with a take over bid or an issuer bid,*
  - (d) *prohibiting any person from exercising any or all of the voting rights attaching to any securities, or*
  - (e) *requiring the trial of an issue.*
- (2) *If, in a proceeding under subsection (1), the executive director is not the applicant, the executive director*
- (a) *must be given notice of the application, and*
  - (b) *may appear at the proceeding as a party.*

### **MI 62-104 TAKE OVER BIDS AND ISSUER BIDS**

- MI 62-104 Take-Over Bids is the harmonized and consolidated take-over policy across all Canadian provinces other than ON. In ON there is the OSC Rule 62-504, which is very similar to this.

### DEFINITIONS AND INTERPRETATION

#### **1.3 Deemed beneficial ownership**

- In determining the beneficial ownership, the offeror (or any person acting in concert) is deemed to be beneficial owner of an equity security (including unissued ones) if:
  - The person is the owner of a convertible security that can be converted into equity security within 60 days.
  - The person has a right or obligation permitting or requiring him to acquire equity securities within 60 days.
- If two or more offerors are acting jointly, the securities that they plan on acquiring are deemed to count wholly towards each offeror's 20% margin.
- This will not be deemed if the acquisition is a part of a lockup agreement in the context of a tendering process.

**1.9 Acting jointly or in concert**

- It is a question of fact as to whether a person is acting jointly or in concert with an offeror.
- People are deemed to be acting jointly or in concert, so that this presumption cannot be rebutted, where
  - There is an agreement, commitment or understanding, to acquire or offer to acquire securities of the same class.
  - The other party is an affiliate of the offeror (offeror has >20% ownership)
- People are presumed to be acting jointly or in concert, so that this presumption can be rebutted, where
  - There is an agreement, commitment or understanding, and intention to exercise voting rights
  - The other party is an associate of the offeror (offeror has between 20% and 10% ownership).
- This will not be deemed if the acquisition is a part of a lockup agreement in the context of a tendering process.

## RESTRICTION ON ACQUISITION OR SALES

**2.2 Restrictions on acquisitions during take-over bid**

- From the day of the announcement of the TOB until the expiry of the bid, an offeror must not offer to acquire ( or make an agreement, commitment or understanding to acquire) any securities of the class that are subject to a TOB (or convertible into them) otherwise than under the bid.
- Exceptions to this:
  - The intention of the offeror is to make purchases and that intention is stated in the bid circular or a news release.
  - The number of securities does not exceed 5% of the outstanding securities of that class;
  - The purchases are made in the normal course on a published market;
  - The offeror issues and files a news release immediately after the close the market on each day on which securities have been purchased under this subsection disclosing the following information:
    - Name of purchaser
    - Number of securities
    - Highest price paid.

**2.4 Restrictions on acquisitions before take-over bid**

- Pre-bid integration rules are concerned with the transactions made in the 90 days prior to the bid.
- This will be triggered if an offeror has purchased shares within 90 days before the TOB, in a transaction not generally available on identical terms to holders of that class of securities
- The offeror has to offer the highest consideration paid and acquire the percentage of securities equal to highest percentage acquired from an individual holder from previous transaction.
- To avoid falling under the pre-bid integration rules, offeror can simply wait 90 days before making the bid.
- But the problem with this is that due to disclosure requirements, the market will get a notice of someone putting themselves into a TOB position, and will trade the shares up in anticipation of the bid.

**2.5 Restrictions on acquisitions after bid**

- For 20 business days after the expiry of a bid, whether or not any securities are taken up under the bid, an offeror must not acquire or offer to acquire securities of the class subject to the bid, except by way of a transaction that is generally available to holders of that class of securities on identical terms.

**Pre-bid Integration Rules Example:**

CO has 1,000,000 shares outstanding. X started out with 1,000 (10%) at FMV of \$10.00 and bought an additional 900 (9%) from the other SHs.

- SH1: Held 600 shares, X bought 300 shares for \$11.50 (50% of shares held by SH1)
- SH2: Held 400 shares, X bought 100 for \$10.50 (25% of shares held by SH2)
- SH3: Held 600 shares, X bought 200 for \$14.00 (33.3% of shares held by SH3)
- SH4: Held 150 shares, X bought 100 for \$10.00 (66.6% of shares held by SH4)
- SH5: Held 200 shares, X bought 200 shares at \$12.00 (100% of shares held by SH5)
- There is no TOB issue yet, as X has less than 20%.
- If X wants to buy more shares, would have to offer to buy 100% of all the shares (highest percentage of shares bought from individual holder in the past 90 days) and at price of minimum \$14.00 (highest bid price in the past 90 days).

### MAKING A BID

#### **2.8 Duty to make bid to all security holders**

- Offeror must make the bid to all SHs of the class of securities in the local jurisdiction.

#### **2.9 Commencement of bid**

- Offeror must commence the bid by publishing an ad in a major daily newspaper, and by sending the bid to all SHs

#### **2.10 Offeror's circular**

- An offeror making a bid must prepare and send, a Bid circular, of either 62-104F1 (TOB) or 62-104F2 (Issuer Bid)

#### **2.11 Change in information**

- If there is a material change, offeror has to issue notice of change to TOB circular.

#### **2.12 Change in terms of bid**

- If there is a variation in the terms of the bid, the offeror must issue notice of change.
- If this is done in less than 10 days prior to expiry of the bid, the bid must be extended to expire at least 10 days after notice of change is issued.

### OFFEREE ISSUER'S OBLIGATIONS

#### **2.17 Duty to prepare and send directors' circular**

- The BD of the target CO bears responsibility to inform their SHs when a TOB has been made
- Thus, the BD has 15 days to evaluate the offer and then to send out the Director's circular.
- This circular must do one of three things:
  - Recommend SHs to accept or reject the bid
  - Advise that the BD will not be giving a recommendation and give reasons why
  - Advise that the BD is still considering the bid and will give recommendation before bid is finalized.

#### **2.18 Notice of change**

- If there is a material change to the nature of the bid after the circular has been issued, the BD has to inform the SHs with a notice of change.

#### **2.20 Individual director's or officer's circular**

- The CO must publish dissent views of any directors.

### OFFEROR'S OBLIGATIONS

#### **2.23 Consideration:**

- Offeror must offer the same consideration to all SHs of target CO.
- If offeror raises offer price, he must pay the SHs who already tendered their bid the raised price.

#### **2.24 Prohibition of Collateral Benefit:**

- If someone intends to make TOB, he or anyone acting jointly with him, cannot enter into collateral agreements that have the effect of providing a SH with greater consideration than other SHs of the same class of securities.
- So no sweetened offers of tropical vacations, or parties with hookers and blow
- This doesn't apply to some employment compensation, severance or other employment benefit arrangements.
- This doesn't apply if offeror tries to induce directors or executives to stay with the company after take-over

#### **2.26 Proportionate Take Up and Payment:**

- If a bid is made for less than all of the class of securities subject to the bid and a greater number of securities is deposited than the offeror is bound or willing to acquire, the offeror must take up and pay for the securities proportionately, disregarding fractions, according to the number of securities deposited by each security holder.
- If X wants to buy 500,000 shares, and is offered 800,000 altogether, X cannot pick and chose from which SHs to purchase. He must buy the proportionate amount of shares from each SH (5 shares out of each 8 shares offered).

**2.27 Financing arrangements**

- The offeror has to have his financing arranged prior to making the bid.

## BID MECHANICS

**2.28 Minimum deposit period**

- Offers must be outstanding for at least 35 days so directors in target CO can reasonably consider the offer and also try to find other bids.

**2.29 Prohibition on take up**

- An offeror must not take up securities deposited under a bid until the expiration of 35 days from the date of the bid.

**2.30 Withdrawal of securities**

- A SH may withdraw securities deposited at any time before they are taken up by the offeror.
- If the securities have not been paid for by the offeror within 3 business days after the securities have been taken up.
- There are some exceptions to this, but they seem marginal.

**2.32 Obligation to take up and pay for deposited securities**

- If all the terms and conditions of a bid have been complied with or waived, the offeror must take up and pay for securities deposited under the bid not later than 10 days after the expiry of the bid.
- Offeror must pay for all securities take within 3 business days of taking them.
- Any securities deposited after the offeror began to take up securities must be taken up no later than 10 days after their deposit.
- An offeror may not extend its bid if all the terms and conditions of the bid have been complied with or waived, unless the offeror first takes up all securities deposited under the bid and not withdrawn.

**2.33 Return of deposited securities**

- Offeror must return all shares that are not taken up, or that he knows that he will not take up.

**2.34 News release on expiry of bid**

- Offeror must notify the market when bid has expired.

## EXEMPTIONS

**4.1 Normal course purchase exemption**

- Acquiring less than 5% of the shares at FMV makes one exempt from the TOB rules. There are 4 conditions to satisfy:
  - The bid is for less than 5% of the outstanding securities of a class,
  - Aggregate number of securities acquired in reliance on this exemption by the offeror and persons in concert in last 12 months, is less than 5% of the securities
  - There is a published market for the class of securities that are the subject of the bid;
  - The value of the consideration paid for any of the securities is FMV.
- The period is counted from the last purchase of shares within the last 12 months.
- This can be used repeatedly year after year to incrementally creep up one's position.

**4.2 Private Agreement Exemption**

- Acquiring less than 5% of shares at less than 115% of FMV makes one exempt from the TOB rules. Yet again it takes four conditions to satisfy this:
  - Purchases are made from less than 5 people,
  - Bid is not made generally to SHs of that class (so long as there are more than 5 security holders of the class),
  - If there is a published market for the securities acquired, price paid must less than 115% market price, based on a 20 day average.
  - If there is no published market for the securities acquired, there has to be a reasonable basis for determining that the price paid less than 115%.
- No cap on share percentage owned, as in 4.1. So this enables "creeping" TOBs.
- Allows unequal treatment of SH by giving room for 15% control premium in the private purchase agreements.
  - However, if the shares exchanged here give someone a control position, the offeree will probably want much more than a 15% control premium. Standard practice can go as high as 300%.

## 463.7 TAKE-OVER BIDS

- If an offeror knows or ought to know that the person selling the shares has acquired them to sell them under this exemption, then all the people that that person bought the shares from will count towards the “5 person” limit.

### **Combining the Exemptions:**

- 4.1 has a time rule, so an offeror should purchase under 4.1, then turn to 4.2 if he wants to purchase even more shares.
- One may also use 4.2 more than once, according to some lawyers.
- BCSecCom are trying to limit this practice.

### **4.3 Non-reporting issuer exemption**

- Private COs that have no listed shares and no disclosure obligations, are exempt from TOB.

### **4.4 Foreign take-over bid exemption**

- Where less than 10% of outstanding equity interest is held by Canadians (as per addresses in offeree's books)

## REPORTS AND ANNOUNCEMENTS OF ACQUISITION

### **5.2 Early warning**

- Any acquisition that puts a SH over 10% limit obliges him to issue a press release and within 2 business days file a report as per NI 62-103
- Any subsequent acquisition of additional 2% (12%, 14%, 16%, etc.) requires a further round of notice.
- The investor cannot trade the security for a day after having made the release, to allow the markets to digest the information. This does not apply to those who have more than 20%.

### **5.3 Acquisitions during bid**

- If there is a bid in progress, and a SH acquires shares that put him over 5%, he must issue a news release, containing his name, his position, his purpose, and the market where the shares were traded.
- Any subsequent acquisition of additional 2% requires a further round of notice.

Most of the same rules applicable to take over bids are also applicable to issuer bids. But these are not on the exams, so they can go fuck themselves.

## BRIEF OVERVIEW OF DEFENSE TACTICS

**White Knight Defence:** A friendly acquisition of a CO that is a subject to a hostile bid. The intention of the acquisition is to circumvent the take-over of the object of interest by a third, unfriendly entity, which is perceived to be less favorable. The knight might defeat the undesirable entity by offering a higher and more enticing bid, or strike a favorable deal with the management of the object of acquisition. This will often include a bust up fee that guarantees cash to the white knight, which is paid to it in the case of a failed defense.

**White Squire Defence:** A defense similar to a white knight, except that it only exercises a significant minority stake, as opposed to a majority stake. A white squire doesn't have the intention, but rather serves as a figurehead in defense of a hostile takeover. The white squire may often also get special voting rights for their equity stake.

**Crown Jewels Defence:** A strategy in which the target CO sells off its most attractive assets to a friendly third party or spin off the valuable assets in a separate entity. Consequently, the unfriendly bidder is less attracted to the CO assets. Other effects include dilution of holdings of the acquirer, making the take-over uneconomical to third parties, and adverse influence of current share prices.

**Standstill Agreement:** An strategy where the hostile bidder agrees to limit its holdings of a target CO for a period of time, in exchange for confidential information. In many cases, the target CO is willing to purchase the potential raider's shares at a premium price, thereby enacting a standstill or eliminating any takeover chance. By establishing this provision with the prospective acquirer, the target firm will have more time to build up other takeover defenses.

**Staggered Board Structure:** A practice governing the BD in which only a fraction (often one third) of the members of the BD is elected each time instead of en masse (where all directors have one-year terms). Staggered boards have the effect of making hostile TOB attempts more difficult. When a BD is staggered, hostile bidders must win more than one proxy fight at successive AGMs in order to exercise control of the target CO. This is great, but in Canada we do not have them for some reason.



## 463.7 TAKE-OVER BIDS

To induce a bid or a support agreement from a white knight, a CO has a number of methods of making itself a more lucrative.

**Break Fee:** A fee the offeree pays to a new offeror as an inducement to step in and prevent a takeover by someone else. The standard practice is about 2-4% of the offer's size. Often, this will cover costs incurred by bidder (legal fees, admin costs, etc).  
**Asset Option:** An agreement for bidder to acquire part of target CO's assets.  
**Open Lock-up Agreement:** An agreement whereby a offeree SH grants an option to the offeror to purchase his shares, thus ensuring a foothold for the offeror. An open lock-up allows offeree to withdraw if a better offer comes along.  
**Hard Lock-up Agreement:** Same as above, but unconditional.  
**No-shop Provision:** An agreement, which, once signed, prevents the Board from looking for a competing bid. It could also prohibit the Board from accepting any other offers, but this is most likely going to be a violation of their fiduciary duty.  
**Support Agreement:** An instrument of a friendly takeover bid, whereby the bidder commits to moving forward with the transaction at an agreed price and quantity, and the Board of the target CO agrees to recommend that SHs tender into the bid, and that the target CO will run in the normal course of business until the completion of the bid. In addition, the Board will usually sign a no-shop provision, but will reserve the right to respond to unsolicited inquiries and to recommend a competing transaction if it amounts to a "superior proposal" for the SHs. There is a potential issue of fettering to be decided on circumstances, and can be solved with a "fiduciary out" clause.

An offeror seeking to overturn various defense tactics would have two avenues of action, based on the tactics used.

- Break fee, asset option, white knight, etc. should be addressed through the courts, which have the power to rescind contracts, grant damages, injunctions, etc. But it may take more time, and the standards of proof are higher.
- SRP are best done through the SecCom, which can cease trade and implement lesser remedies, but have lower standards of proof.

### NP 62-202: TAKE-OVER BID DEFENSIVE TACTICS

- This is a national policy guideline that describes the SecCom position on defensive tactics.
- Management of the target CO may take one or more of the following actions in response to a bid that it opposes:
  - Attempt to persuade SHs to reject the offer
  - Take action to maximize the return to SHs including soliciting a higher offer from a third party
  - Take other defensive measures to defeat the bid.
- The primary objective of TOB legislation is the protection of the bona fide interests of the SHs of the target CO.
  - The secondary objective is to provide a regulatory framework where TOBs may proceed in an open and even-handed environment.
- It is not a good idea to have specific code of conduct that will apply to all cases, but specific cases may be scrutinized, if:
  - There is an issuance of securities representing a significant percentage of outstanding securities of target CO.
  - There is a sale or acquisition, or agreeing to such, of assets of material amount
  - There is a K or corporate action that deviates from normal course of business
- The policy approach is that unrestricted TOB auctions yield more favourable results.
- Regulators are prepared to override take-over defenses, especially SRPs in appropriate cases.

### SHAREHOLDER RIGHTS PLANS

- SecCom is influenced by the specific circumstances, and seems to tailor the decision to the facts of the case.
- This is also helped by the fact that the value of precedence at SecCom not the same as in normal Court.
- SecCom at first took a broad interpretation of whether SRPs are valid, but over the last two decades the the interpretation has gotten narrower. Now, it seems to just depend on who's on the panel you appear in front of, and what they had for breakfast.

**Shareholder Rights Plans (Poison Pill):** The target CO issues rights to existing SHs to acquire a large number of new securities, usually common or preferred shares. The new rights typically allow holders (other than a bidder) to convert the right into a large number of common shares if anyone acquires more than a set amount of the target's stock (typically 15%). This dilutes the percentage of the target owned by the bidder, and makes it more expensive to acquire control of the target.

- Nobody would knowingly trigger a SRP, as it causes massive dilution of shares and ownership
- In Canada, the legality for SRPs has never been fully established, and many lawyers think that these are sketchy.

**Tactical SRP:** An SRP that is enacted by the BD without a SH approval.

**IN THE MATTER OF CANADIAN JOREX LTD. [1992] ON SEC COM*****If the SRP is against public interest as declared by NP 62-202 it will be struck down***

**Facts:** Mannville Oil & Gas announced its intention to make a take-over bid for Jorex, offering 0.85 of a share of Mannville for each share of Jorex tendered. Jorex's BD recommended rejecting the bid. BD also decided to adopt a SRP. The adoption of the SRP did not result in any enhancement of the Mannville bid, but Canadian Trans-Arctic made a cash bid, at \$2.70 a share, for 55% of the shares of Jorex. BD recommended acceptance, and waived the SRP conditions to allow for the Trans-Arctic bid. Mannville complained that SRP was contrary to the public interest and should be stopped.

**Issue:** Is the SRP contrary to the public interest?

**Discussion:**

- No Canadian court or securities regulator has yet had to rule on the overall validity of SRPs. This is not the issue here. The issue here is situation specific.
- In this case the SRP is against public interest.
  - It is clear that the Mannville bid could not proceed unless the effect of the SRP was first removed.
  - Maintaining the SRP in effect against Mannville was not going to result in anyone else joining in the Jorex auction.
  - Maintaining of the pill wasn't going to get Manville to raise it's own bid.
- The primary concern in take-over bid regulation is whether the defence tactics are likely to deny or severely limit the ability of the SHs to respond to a take-over bid or a competing bid.
- In this case, the SRP clearly prevented a valid bidder from entering the auction, and deprived the SHs of choice.
- Because of this the SRP is voided.

**Ruling:** SRP struck down.

**Circumstances to Consider with SRPs:** (as per *Re Royal Host Estate Investment Trust* [1999] BCSecCom)

- Whether SH approval of SRP was obtained.
- If SRP does not have SH approval, it generally will be suspect; however, SH approval itself will not establish that a SRP is in the best interest of SHs (*Cara Operations*).
- When the plan was adopted.
    - If SRP is not put in place before a particular bid becomes evident then it is very likely that it is directed at particular bid (*Cara Operations*).
  - Whether there is broad SH support for continued operation of the plan.
  - The size and complexity of target CO.
  - Other defensive tactics, if any, have been implemented by the target CO. If such are present, then the SRP is clearly an attempt to frustrate the specific bid.
  - Steps taken by CO to find a better bid.
  - Likelihood that, if given further time, the target CO will be able to find a better bid.
  - Number of potential, viable offers.
  - Nature of the bid, and whether it is coercive or unfair.
  - Length of time since bid was announced.
    - Regulators pressured by institutional SHs have agreed to waive 35 day requirement and say it should be ~45-55 days or longer.
  - Likelihood that the bid will not be extended if the SRP is not terminated.

**NEO MATERIAL TECHNOLOGIES INC. AND PALA INVESTMENTS [2009] ON SEC COM**

***SRPs may be adopted to safeguard the long-term interest of SH, consistent with reasonable business judgements.***

**Facts:** Neo had an initial SRP written in the Articles, but in the face of a bid from Pala, Neo adopted a second SRP amending the minimum tender requirement from 50% to 100% to "stop creeping ownership plays." This was approved by a majority SH vote, and SHs provided with adequate information and were not coerced or unduly pressured into their decision. Neo's BD refused to put a Pala proposal to SH vote removing the SRP based on alleged timing violations. Pala asked SecCom to set aside the SRP.

**Issue:** Under what circumstances should a SecCom cease a trade for a SRP based on public interest?

**Discussion:**

- The duty here is to the CO in general, not to the SHs, because it is not clear that the fall of the CO is inevitable. (Based on *BCE*: best interest of the CO is more than short-term share value for the SHs.)
- It is an error to focus on just investor protection; public interest involves a consideration of the public confidence in the capital markets.

## 463.7 TAKE-OVER BIDS

- The second SRP was a direct response to Pala's offer.
- 81% of SH voted in favour and the proxy turnout was among the highest in years and the SH were properly informed by the Director's Circular setting out cogent financial reasons for preventing the bid: liquidity issues, undervaluation, the absence of a control premium, etc.
- To interfere where no legislation prohibits the action, the said action must be abusive, and must show a broader impact on capital markets and their operation.
- The *Royal Host* Factors are important, however, SRPs are very fact and case-by-case specific. SH approval is cogent, however, does not necessarily impede a public interest ruling and depends on freedom from coercion and adequate information.
- SRPs may be adopted to safeguard the long-term interest of SH, consistent with reasonable business judgements.
- The decision of the BD to adopt the second SRP and not to seek an action was within a reasonable range of alternatives and consistent with the business judgment rule and their fiduciary duty to the CO.
- Note that this is the position of the OnSecCom. BCSecCom has taken a different approach to SH-approved SRPs in *Lions Gate* below.

**Ruling:** SRP stays in place.

### **ICAHN PARTNERS LP V. LIONS GATE ENTERTAINMENT CO [2010] BC SEC COM**

***If the defensive tactics does not stimulate and auction, such as an SRP with an impossible permitted bid, then the SH should be able to decide for themselves whether to tender into the take over bid.***

**Facts:** On February 16, 2010, Icahn Partners, which was the second largest SH of Lions Gate at the time, commenced a bid to acquire shares of LG. In response, the BD of LG issued a circular to its SHs in which it recommended that they reject the offer made by Icahn, and it authorized an SRP in which all of the SHs of LG other than Icahn would be given the right to purchase further shares at approximately one-half of FMV if a bidder acquired more than 20% of the outstanding shares. During the course of the battle, Icahn Group changed the bid to increase it and to eliminate the minimum tender requirements (making it less coercive). When all this failed to sway LG, Icahn applied to the SecCom for the cease-trade order in respect of the SRP pursuant to s. 161(1)(b) of the *BCSA*, which the SecCom granted. This terminated the SRP and allowed the bid to proceed. On appeal, LG submitted that it was unreasonable for the cease-trade order to have been issued prior to a SH vote on the SRP and that this thereby deprived the SH of the opportunity to respond collectively to Icahn's bid.

**Issues:** Is this SRP in public interest?

**Discussion:**

- In reaching its decision SecCom considered NP 62-202 and the factors identified in the decision of *Re Royal Host*.
- SecCom expressed the view that the amended bid of the Icahn Group was not coercive, and it concluded that it was in the public interest to order that trading in the rights cease so that the SHs of LG would have the opportunity to accept or reject the bid.
- With the SRP in place, SHs of LG would not be deprived of the opportunity to respond to the TOB.
- Although SH approval is a relevant factor (see *Royal Host*), it is not determinative. In *Cara Operations Ltd.* [2002] ONSecCom it was said that if an SRP does not have SH approval, it generally will be suspect as not being in the best interest of the SHs; however, SH approval of itself will not establish that an SRP is in the best interest of the SHs.
- The standard of review on this appeal is one of reasonableness, as per *Pezim*, where it was agreed that SecComs are more versed in these matters than appeal courts.
- It has not been demonstrated that the Commission's decision was unreasonable

**Ruling:** Appeal dismissed and cease trade is in place.

## ENFORCEMENT GENERALLY

## BCSA PART 18 ENFORCEMENT

- In general, when SecCom considers someone to be in violation of the Act or regulations, it has two ways of enforcing compliance. It can either make an application to Supreme Court, where Crown would take over and prosecute under ss. 155-160, or use its administrative powers under ss. 161-164.

## COURT ENFORCEMENT

**155 Offences generally**

- (1) *A person who does any of the following commits an offence:*
- fails to file, provide, deliver or send a record that*
    - is required to be filed, provided, delivered or sent under this Act, or*
    - is required to be filed, provided, delivered or sent under this Act within the time required under this Act;*
  - contravenes any of section 34, 49 to 57, 57.2, 57.3, 57.5, 57.6, 58, 59, 61, 85 (b), 87, 121, 122, 124, 125, 148 or 168.1 (1) of this Act;*
  - fails to comply with a decision made under this Act;*
  - contravenes any of the provisions of the regulations that are specified by regulation for the purpose of this paragraph;*
  - contravenes any of the provisions of the commission rules that are specified by regulation for the purpose of this paragraph.*
- (2) *A person that commits an offence under this Act is liable to a fine of not more than \$3m, or to imprisonment for not more than 3 years, or both.*
- (4) *If a person, other than an individual, commits an offence under subsection (1), an employee, officer, director or agent of that person who authorizes, permits or acquiesces in the offence commits the same offence whether or not that person is convicted of the offence.*
- (5) *Despite subsection (2), if a person has contravened section 57, 57.2 or 57.3 (insider trading), the fine to which the person is liable is*
- not less than any profit made by all persons because of the contravention of section 57, 57.2 or 57.3, and*
  - not more than the greater of*
    - \$3 million, and*
    - an amount equal to triple any profit made by all persons because of the contravention of section 57, 57.2 or 57.3.*

- Because the standard of proof in a s.155 prosecution is BARD, s.155 is not as commonly used, as a SecCom would prefer to do all their work in house under s.162 with a BP standard.
- Section 155(1)(b) is the most common one.

**155.1 Additional remedies**

*If the court finds that a person has committed an offence under section 155, the court may make an order that*

- the person compensate or make restitution to another person, or*
- the person pay to the commission any amount obtained, or payment or loss avoided, directly or indirectly, as a result of the offence.*

**157 Order for compliance**

*(1) In addition to any other powers it may have, if the commission considers that a person has contravened or is contravening a provision of this Act or of the regulations, or has failed to comply or is not complying with a decision, and the commission considers it in the public interest to do so, the commission may apply to the Supreme Court for one or more of the following:*

- an order that*
    - the person comply with or cease contravening the provision or decision, and*
    - the directors and officers of the person cause the person to comply with or to cease contravening the provision or decision;*
  - an order that the person pay to the commission any amount obtained, or payment or loss avoided, directly or indirectly, as a result of the failure to comply or the contravention;*
  - an order setting aside a transaction relating to trading in securities or exchange contracts;*
  - an order that a security or exchange contract be issued or cancelled;*
  - an order that a security or exchange contract be purchased, disposed of or exchanged;*
  - an order prohibiting the voting of a security or the exercise of a right attaching to a security or exchange contract;*
  - an order appointing a director of the person that is the subject of the application;*
  - an order that the person repay a holder of a security or an exchange contract money paid by the holder for the security...*
  - an order that the person compensate or make restitution to any other person;*
  - an order that the person pay general or punitive damages to any other person;*
  - an order that the person correct a record;*
  - an order that the person rectify any contravention of this Act, or the regulations, to the extent that rectification is possible.*
- (2) On an application under subsection (1), the Supreme Court may make the order applied for and any other order the court considers appropriate.*

## 463.8 ENFORCEMENT AND LIABILITY

(3) An order may be made under this section even though a penalty has already been imposed on that person in respect of the same non-compliance or contravention.

- Note under 157(3) all of this can be in addition to any other order or penalty imposed.
- The consideration under this section is on BP
- This is once again not used as often.

### **159 Limitation period**

Proceedings under this Act, other than an action referred to in section 140, must not be commenced more than 6 years after the date of the events that give rise to the proceedings.

### **160 Costs of investigation**

(1) A person convicted of an offence against this Act or the regulations is liable, after the review and filing of a certificate under this section, for the costs of the investigation of the offence.

(2) [the rest of this section is concerned with the filing and processing of the aforementioned certificates].

## ADMINISTRATIVE ENFORCEMENT

### **161 Enforcement orders**

(1) If the commission or the executive director considers it to be in the public interest, the commission or the executive director, after a hearing, may order one or more of the following:

- that a person comply with or cease contravening ... a provision of this Act or the regulations, a decision, or a bylaw, rule, or other regulatory instrument or policy ...
- that all persons, the person or persons named in the order, or one or more classes of persons cease trading in, or be prohibited from purchasing, any securities or exchange contracts, a specified security or exchange contract or a specified class of securities or class of exchange contracts;
- that any or all of the exemptions set out in the regulations do not apply to a person;
- that a person
  - resign any position that the person holds as a director or officer of an issuer ...
  - is prohibited from becoming or acting as a director or officer of any issuer ...
  - is prohibited from becoming or acting as a registrant ...
  - is prohibited from acting in a management or consultative capacity in connection with activities in the securities market, or
  - is prohibited from engaging in investor relations activities;
- that a registrant, issuer or person engaged in investor relations activities
  - is prohibited from disseminating to the public, or authorizing the dissemination to the public, of any information ...
  - is required to disseminate to the public ... any information or record relating to the affairs of the registrant or issuer ...
  - is required to amend ... any information or record of any kind described in the order before disseminating the information or record to the public or authorizing its dissemination to the public;
- that a registration or recognition be suspended, cancelled or restricted or that conditions, restrictions or requirements be imposed on a registration or recognition;
- if a person has not complied with this Act, the regulations or a decision..., that the person pay to the commission any amount obtained, or payment or loss avoided, directly or indirectly, as a result of the failure to comply or the contravention;
- that a person be reprimanded.

- This is more common than s.157 as it is done in house by the SecCom.
- Under s.161(2) SecCom can issue a temporary order if it considers that there is no time to hold a hearing under s.161(1).
- But a hearing still has to take place, and after this has happened, SecCom can impose a penalty under s.162

### **162 Administrative penalty**

If the commission, after a hearing,

(a) determines that a person has contravened

- a provision of this Act or of the regulations, or
- 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.

- This is a general administrative penalty that the SecCom can slap on whoever they feel like. Because of this it's more commonly used than s.155.

## 463.8 ENFORCEMENT AND LIABILITY

- Note that whereas s.161 can be done by the executive director alone, s.162 must be done by the entire SecCom after a hearing.

### **163 Enforcement of commission orders**

- (1) *If the commission has made a decision after a hearing, the commission may file the decision at any time in a Supreme Court registry by filing a copy of the decision certified by the chair of the commission.*
- (2) *On being filed under subsection (1), a decision of the commission has the same force and effect, and all proceedings may be taken on it, as if it were a judgment of the Supreme Court.*

- If, after ss.161-162 the offending party is still acting a fool and refusing to do as he's told, SecCom can apply to court.
- *Asbestos Shareholders v. OSC*
  - Purpose of the public interest powers is not punitive, but prospective to protect the integrity of security markets.
  - Directors powers are broad but not unlimited
  - When the SecCom is exercising powers must show it's aligned with purposes of Act
- *Re Cartaway* [2004] SCC.
  - Standard of review is reasonableness.
  - SecCom really went to cleaners with these guys and called it "general deterrence" and made an example of the CO.
  - SCC said that while deterrence is allowed under the public interest power, the power is not unlimited.

### **RE SIDDIQI [2005] BC SEC COM**

***An order under s.161 can be made for the purpose of general deterrence in the public interest.***

**Facts:** Siddiqi was in the business of assisting public companies in raising capital. He was involved in a series of transactions involving a mining CO AIS Resources. Executive director alleges that Siddiqi traded AIS with knowledge of undisclosed material facts and changes, and that he manipulated the market in AIS shares. He was found guilty, and SecCom considered whether it can use s.161 to the max.

**Issues:** Can public interest be relied on for general deterrence?

#### **Discussion:**

- Factors court considers when making order under s. 161:
  - How much damages done
  - Wrongful enrichment
  - Previous history of conduct
  - Harm to investors
  - Risk to market of continued participation
  - Damage to integrity of capital markets of BC
  - Factors mitigating person's conduct
  - Fitness to bear responsibility
  - Need for deterrence
- SecCom can exercise its s.161 power as a general deterrence

**Ruling:** Some big trouble for D.

## ENFORCEMENT OF FAILURE TO FILE OR DISCLOSE

### **164 Failure to comply with filing requirements**

- (1) *For the reasons set out in subsection (2), the commission or the executive director, without a hearing, may order that all persons, the person or persons named in the order ... cease trading in a specified security or exchange contract or in a class of security or class of exchange contract.*
- (2) *The commission or the executive director may make an order under subsection (1) if the issuer of the security, the exchange on which the exchange contract is traded or the person in respect of which the order is made*
  - (a) fails to file a record required to be filed under this Act, provided that the order is revoked as soon as practicable after the record referred to in the order, completed in accordance with this Act and the regulations, is filed, or*
  - (b) files a record required to be filed under this Act which record has not been completed in accordance with this Act or the regulations, provided that the order is revoked as soon as practicable after the record referred to in the order, completed in accordance with this Act and the regulations, is filed.*

- If the issue at hand is a simple failure of general disclosure, then SecCom can make a quick and easy cease trade order, until the failure is rectified.

## PROSPECTUS DISCLOSURE FAILURE

### FAILURE TO DELIVER PROSPECTUS

- **Penal:** Under s.155, this is a general offence with fine of no more than \$3mil. or 3 years in prison
- **Administrative:** Under s.162, as an administrative sanction for breach of s.61, SecCom can make an order directing compliance with delivery obligation, order to cease trade, denial of exemptions, a reprimand or suspension, cancellation or restriction of registration for trading.
- **Statutory Civil:** Under s.135, purchaser has a right of action for rescission or damages against the dealer, subject to limitation period (within 180 days of the transaction, for damages, after the purchaser first had knowledge of the fact).

### FAILURE TO FILE PROSPECTUS

- **Penal:** Under s.155, this is a general offence with fine of no more than \$3mil. or 3 years in prison
- **Administrative:** Under s.162, as an administrative sanction for breach of s.83, SecCom can order to cease trade until prospectus is filed and receipt obtained, denial of exemptions, order that a person resign from any position as a director or officer, or be prohibited from becoming or acting as a director or officer of the issuer, reprimand, suspension, cancellation or restriction of a registrant's registration.
- **Statutory Civil:** Under s.135, purchaser has a right of action for rescission or damages against the dealer, subject to limitation period (within 180 days of the transaction, for damages, after the purchaser first had knowledge of the fact).
- **Common Law:** Under common law, party to a K can declare that the K is void and be entitled to recover the price paid for the securities. The action could be based on the general principle of contract law that a contract expressly or impliedly prohibited by statute is void (though this may be tough in BC)

## CONTINUOUS DISCLOSURE FAILURE

### FAILURE OF PERIODIC DISCLOSURE

- **Administrative:** Under s.161 (public interest) and s.162 (breaching any provision of Act), SecCom can issue a cease trade order, prevent one from being director or officer of any issuer; pull license of registered dealer; etc.

### FAILURE OF TIMELY DISCLOSURE

- **Penal:** Under s.155, this is a general offence with fine of no more than \$3mil. or 3 years in prison Also consider additional remedies of restitution under s.155.1
- **Administrative:** Under s.161 (public interest) and s.162 (breaching any provision of Act), SecCom can issue a cease trade order, prevent one from being director or officer of any issuer; pull license of registered dealer; etc.
  - Also see compliance orders under s.157(1)
- **Statutory Civil:** For securities in secondary market, under s.140.3(4) individual can sue issuer, agent, D&O, or influential person for damages.

### **89 Halt trading order**

(1) If

(a) the commission or the executive director

- considers that there are unexplained and unusual fluctuations in the volume of trading in, or market price of, a security or exchange contract,
- becomes aware of information, ... that when disclosed to the public may cause or is likely to cause unusual fluctuations in the volume of trading in, or market price of, a security or exchange contract,
- considers that there may have been a material change in the business or operations of an issuer that, when disclosed, could significantly affect the market price of a security issued by it, or
- considers that circumstances exist or are about to occur that could result in other than an orderly trading of a security or exchange contract, and

(b) the commission or the executive director considers it to be in the public interest,

the commission or executive director may, without a hearing, order that all trading in that security or exchange contract be halted for a specified period not longer than 3 business days.

## ENFORCEMENT OF MISREPRESENTATION

**Misrepresentation:** Untrue statement of material fact or omission to state a material fact if such is required to be stated or is necessary to prevent misleading people. Note that this doesn't require knowledge that the statement is untrue.

**Material Misleading Disclosure:** There is a difference between perfect disclosure (which almost never happens), acceptable disclosure, which is not perfect, but not misleading, and material non-disclosure or material misleading disclosure, which omits material facts. The appropriate standard for materiality (as per *Sparling v. Royal Trustco* [1984] ONCA) is that an omitted fact is material if there is a substantial likelihood that a reasonable SH would consider it important in deciding how to vote.

- **Penal:** Under s.155, this is a general offence with fine of no more than \$3mil. or 3 years in prison
- **Administrative:** Under s.162, as an administrative sanction for breach of s.63 whereby one must provide full, plain, and true disclosure in the prospectus, SecCom can make an order directing compliance with delivery obligation, order to cease trade, denial of exemptions, a reprimand or suspension, cancellation or restriction of registration for trading.
- **Common Law:** can be pursued under contract or tort law:
  - Contractual Claims: PL needs to say that the K of purchase incorporated the information in prospectus, and sue for breach of K if misrepresentation in the prospectus (???)
    - But if the misrepresentation is an honest mistake, then no damages will be allowed, merely rescission.
  - Tort Claims:
    - Under the old case of *Derry v. Peek*, the tort claims were limited to narrow cases of fraud. Now we have moved to negligent misrepresentation thanks to *Hedley v. Byrne*.
  - As per *Queen v. Cognos* PL needs to establish:
    - Duty of care: which is likely to be found as a special relationship? Was it foreseeable?
    - That representations were untrue or misleading,
    - That representor acted negligently in making them,
    - That representee relied in the misrepresentation in reasonable manner,
    - And that shit was detrimental, so that damages are justified.
- **Statutory Civil:**
  - Statutory civil liability is a whole lot of extra whoopass. It deserves its own bit.
  - For purchaser who bought the securities during the distribution period, go to s.131.
  - For purchaser who bought the securities after the distribution period, go to s.140.3.

### **Statutory Civil Liability or Common Law Liability?**

- Common law is not displaced by statutory civil liability.
- But statutory liability goes considerably beyond common law
- It sets out a list of persons who owe a duty, so there no difficulty in establishing duty of care
- Statutory Civil Liability expressly applies to misstatements or omissions
- It also assumes reliance, negligence, and causation (makes them defences). Thus it reduces PL's BoP.

## BCSA PART 16: CIVIL LIABILITY

### **131 Liability for misrepresentation in prospectus**

- If a prospectus contains a misrepresentation, a purchaser who purchased a security during the period of distribution is deemed to have relied on the misrepresentation and has a right for damages against:
  - Issuer or selling SH
  - Every UW
  - Every director
  - Every person who consented to disclosure
    - But only limited to misrepresentation in the information that that person was responsible for
  - Every person who signed the prospectus
- The purchaser has a right of rescission against:
  - Every UW that they purchased from
- A person is not liable if they can prove that
  - The purchaser had knowledge of misrepresentation. This is the only one available to issuers (along with limitation for depreciation).
  - The prospectus was filed without the person's knowledge or consent
  - After the issue and before the purchase, the person founds out about any misrepresentation and took steps



## 463.8 ENFORCEMENT AND LIABILITY

- For any reliance on experts, where the person had no reasonable grounds to believe that there is a misrepresentation.
- If the person is the expert the person had, after reasonable investigation, reasonable grounds to believe that the relevant part of the prospectus fairly represented his report.
- If misrepresentation is based on a false statement by an official, the person has reasonable grounds to believe that it was not false.
- A person is not liable for misrepresentation in FLI if they can prove that
  - There was reasonable cautionary language
  - The person had reasonable grounds for FLI
- In an action for damages D is not liable for all or any part of the damages that D proves does not represent the depreciation in value of the security resulting from the misrepresentation.
- The liability of all persons is joint and several as between themselves with respect to the same cause of action.
- The amount recoverable by a PL must not exceed the price at which the securities were offered to the public.

### **132 Liability for misrepresentation in circular or notice**

- If a TOB circular (and a few more) contains a misrepresentation, a recipient of the TOB circular is deemed to have relied on the misrepresentation and has a right
  - For rescission against the offeror
  - For damages against:
    - Offeror
    - Every director of the offeror
    - Every person who consent is prescribed
    - Every person who signed the TOB circular
- The defenses here are largely the same as in s.131.

### **132.1 Liability for misrepresentation in prescribed disclosure document**

- If a prescribed disclosure document contains a misrepresentation, a purchase who purchases the security offered by the document is deemed to have relied on the misrepresentation and has a right
  - For rescission against the issuer
  - For damages against:
    - Issuer
    - Every director of the issuer
    - Every person who signed the document.
- The defenses here are largely the same as in s.131.
- As per s.133, in determining what is a reasonable investigation or what are reasonable grounds for belief for the purposes of sections 131 and 132, the standard of reasonableness must be that required of a prudent person in the circumstances of the particular case.

### **140 Limitation period**

*Unless otherwise provided ... an action to enforce a civil remedy created by this Part or by the regulations must not be commenced*

*(a) in the case of an action for rescission, more than 180 days after the date of the transaction that gave rise to the cause of action, or*

*(b) in the case of an action other than for rescission, more than the earlier of*

*(i) 180 days after the plaintiff first had knowledge of the facts giving rise to the cause of action, or*

*(ii) 3 years after the date of the transaction that gave rise to the cause of action.*

## **BCSA PART 16.1: CIVIL LIABILITY FOR SECONDARY MARKET DISCLOSURE**

**Core Document:** Prospectus, TOB circular, director's circular, notice of change in respect of TOB circular, etc.

**Influential Person:** Means in respect of the issuer, a control person, a promoter, or an insider.

### **140.3 Liability for secondary market disclosure**

- Where there is a misrepresentation in a secondary market disclosure a person who acquires or disposes of the issuer's security during the period between the time when the misrepresentation was released and the time when the misrepresentation is publicly corrected, regardless of reliance, a right of action for damages against certain parties.
- The parties differ based on the type of misrepresentation
- Multiple misrepresentations having common subject matter or content may, in the discretion of the court, be treated as a single misrepresentation.
- Where misrepresentation is in a document released by the issuer (s.140.3(1)):

- Issuer
- All directors and any officer responsible for authorization of the document
- Each influential person who knowingly influenced the document
- Each expert party to the document
- Where misrepresentation is in a public oral statement that relates to the business or affairs of the issuer, by a person with authority to speak for the issuer, (s.140.3(2):
  - Person who made the statement (note that if the authority was only apparent, but not authorized, then nobody else is liable)
  - Issuer
  - Any directors and officer responsible for authorization of the statement
  - Each influential person who knowingly influenced the statement
  - Each expert party to the document as the basis of the statement
- Where misrepresentation is in a document or a public oral statement that relates to the issuer, by a person with authority to speak for an influential person (s.140.3(3):
  - Person who made the statement (note that if the authority was only apparent, but not authorized, then nobody else is liable)
  - Issuer if a director or officer authorized the action
  - Any directors and officer responsible for authorization of the action
  - The influential person
  - Any directors and officer of the influential person responsible for authorization of the action
  - Each expert party to the document as the basis of the statement
- Where issuer fails to make a timely disclosure (s.140.3(4):
  - Issuer
  - Any directors and officer responsible for authorization of the failure
  - Each influential person who knowingly influenced the failure

### **140.4 Burden of proof and defences**

- The burden of proof and the defence vary based on the degree and type of misrepresentation
- For a misrepresentation in a non-core document or an oral statement PL has to prove that D (s.140.4(1):
  - Knew that the document or statement contains the misrepresentation, or was willfully blind to this.
  - Or was through action or negligence guilty of gross misconduct in connection with the misrepresentation.
  - The above does not relate to an expert. These are automatically guilty.
- For a failure of timely disclosure PL has to prove that D (s.140.4(2):
  - Knew that the change has occurred and that it was material, or was willfully blind to this.
  - Or was through action or negligence guilty of gross misconduct in connection with the failure to disclose.
  - The above does not relate to issuer or officer of the issuer. These are automatically guilty.
- A person is not liable in relation to a misrepresentation if (s.140.4(5)(6)(9):
  - He can prove that PL acquired or disposed the security with knowledge of the misrepresentation.
  - He can establish due diligence through reasonable investigation and reasonable grounds in truthfulness of the misrepresentation.
  - If the misrepresentation is in FLI, he must prove that the document had reasonable cautionary language and the FLI was reasonable
- A person is not liable of failure to make timely disclosure if (s.140.4(5)(6)(8):
  - He can prove that PL acquired or disposed the security with knowledge of the material change.
  - He can establish due diligence through reasonable investigation and reasonable grounds to believe that no failure would occur.
  - He can prove that the material change has been filed with the SecCom confidentially as per s.85(b) and confidentiality has been properly maintained and procedure observed
- A person is not liable in respect of a misrepresentation in a document if he had reasonable grounds to believe that the document would be released to public. (s.140.4(15))
- A person (other than issuer) is not liable if the action was made without his knowledge and as soon as he found out, he took all steps to rectify the action (s.140.4(16))

### **140.5 Assessment of damages**

- Complex and pointless for this CAN, but it relies on average prices of securities during the time of breach.

### **140.6 Proportionate liability**

- Only liable for damages that one is responsible for

## 463.8 ENFORCEMENT AND LIABILITY

- Exception to this is for those who knowingly made misrepresentation, who may be liable for all damages. That is PL can recover amounts responsible from the other D.

### **140.6 Liability Limits**

- Each D is only liable for lesser of:
  - Aggregate of damages assessed against the person or
  - The liability limits as defined in s.140.1

### **140.8 Leave to Proceed**

- PL must get leave to sue. Court must be satisfied that:
  - Action is being brought in good faith and
  - There is a reasonable possibility that the action will succeed.

### **140.94 Limitation Period**

*No action may be commenced under section 140.3,*

- (a) *in the case of a misrepresentation in a document, later than the earlier of*
  - (i) *3 years after the date on which the document containing the misrepresentation was first released, and*
  - (ii) *6 months after the issuance of a news release disclosing that leave has been granted to commence an action under section 140.3 or under comparable legislation in the other provinces in respect of the same misrepresentation,*
- (b) *in the case of a misrepresentation in a public oral statement, later than the earlier of*
  - (i) *3 years after the date on which the public oral statement containing the misrepresentation was made, and*
  - (ii) *6 months after the issuance of a news release disclosing that leave has been granted to commence an action under section 140.3 or under comparable legislation in other provinces in respect of the same misrepresentation, and*
- (c) *in the case of a failure to make timely disclosure, later than the earlier of*
  - (i) *3 years after the date on which the requisite disclosure was required to be made, and*
  - (ii) *6 months after the issuance of a news release disclosing that leave has been granted to commence an action under section 140.3 or under comparable legislation in another province in respect of the same failure to make timely disclosure.*

## **DEFENSE TO CIVIL LIABILITY**

- The statutory defences are discussed in ss.131-133 for primary market and s.140.4 for secondary market.

### **FIAT V. LEASCO DATA PROCESSING EQUIPMENT CO. [1971] US**

***Completely independent and duplicate investigation not required to establish due diligence but BD are expected to examine documents that were readily available***

**Facts:** Reliance, which was an insurance CO was the target of a TOB by Leasco. As an insurance CO, R was stringently regulated, and required to keep a surplus amount of money to ensure its ability to cover all liabilities. Any surplus besides for that was considered “surplus surplus.” However, as an insurance CO, R was unable to use this surplus surplus for non-insurance purposes. Leasco developed a scheme, where it would take over R, create a holding CO, and transfer the surplus surplus, which it estimated as \$125m, to it to use for non-insurance purposes. It proceeded with the TOB by offering an exchange package of convertible preferred stock and options, in exchange for R’s shares. In the TOB circular L did not mention anything about the surplus surplus, its estimated amount, or L’s plans for it. Initially hostile BD of R were appeased by L’s sweetened offers and guarantees that they retain their jobs. In exchange they recommended that R’s SHs accept the offer, despite dubious tax consequences to the SHs. The offer went through and L acquired 90% of R. Fiat was a SH of R, who launched a class action, alleging also that BD of R failed to disclose the information about the surplus surplus, which was so important to the overall transaction. BD of R claimed due diligence.

**Issue:** What is required for due diligence defence?

#### **Discussion:**

- The court looked at due diligence portions of *Escott v. BarChris* [1968] US, where BD has to conduct a reasonable investigation into the material facts being disclosed.
- Definition of reasonable investigation varies with degree of involvement, expertise, and access to info
- BD failed to fulfill their duty of reasonable investigation.
- L and its BD are liable.

**Ruling:** Damages for PL.

**RE YBM MAGNEX INTERNATIONAL INC. [2003] ONSECOM*****Future materiality and due diligence in failure to disclose.***

**Facts:** YBM was a CO that has its roots in sketchy Eastern European operations. When it went international and legit, its BD put together a Special Committee to investigate some allegations. The Committee arrived to several findings, among which was that YBM was under clandestine investigation by US Attorney Office, that there are suspicious payments being made among its Russian suppliers, there may be some money laundering, and ties to the mob. Typical Russian business climate, in other words. But none of this was disclosed in the prospectus. The BD are alleged to have authorized, permitted or acquiesced in YBM's failure to make full, true, and plain disclosure. They claim that the findings were immaterial, or at least they thought them to be immaterial at the time? The UW in the IPO are also alleged to have signed certificates to prospectuses which, to the best of their knowledge, information, and belief did not contain full, true, and plain disclosure. Furthermore YBM should have disclosed that its auditors had advised YBM that it would not perform any further services for the CO, until YBM had completed an in-depth forensic investigation that addressed specific concerns.

**Issue:** Was the prospectus disclosure faulty?

**Discussion:**

- YBM's disclosure leads the reader to believe that the risks faced by YBM were no greater than the inherent risks faced by any company operating in Eastern Europe at that time.
- But YBM was subject to company-specific risks, as evidenced by the findings of its Special Committee.
- Whether these risks were material is hard to establish on standard tests of materiality, as they are future risks.
- The probability/magnitude test is useful in assessing the occurrence of a future event, but common sense must prevail.
- What about due diligence?
- If a respondent has knowledge of facts, but is mistakenly of the view that they are not material, i.e., if he or she was diligent in ascertaining their materiality but was nevertheless honestly and reasonably mistaken in this respect, the due diligence defence is available.
- In this case there were considerable efforts undertaken by the Board to investigate the facts, ascertain their materiality and decide what constituted full, true and plain disclosure of these facts.
- It is best to consider the reasonableness of the respondents' diligence and their belief from the perspective of a prudent person in the circumstances. This necessarily entails both objective and subjective considerations including their degree of participation, access to the information and skill. This is done on a person by person basis.
  - Insider has a higher standard than outsider
  - Lawyer director is in a better position to assess facts
  - If on Board committee than more liable
  - Outside director on special committee is like an insider
- In the end some have met the defence, whereas others failed.

**Ruling:** I think something happened here. I gave up after 30 pages.

**Reasonable Investigation:** For the purposes of due diligence under s.140.4, the court must consider all relevant circumstances, including:

- The nature of the responsible issuer,
- The knowledge, experience and function of the person,
- The office held, if the person was an officer,
- The existence, if any, and the nature of any system designed to ensure that the responsible issuer meets its continuous disclosure obligations,
- The reasonableness of reliance by the person on the responsible issuer's disclosure compliance system and on the responsible issuer's officers, employees and others whose duties would in the ordinary course have given them knowledge of the relevant facts,
- In respect of a report, statement or opinion of an expert, any professional standards applicable to the expert,
- The extent to which the person knew, or should reasonably have known, the content and medium of dissemination of the document or public oral statement,
- In the case of a misrepresentation, the role and responsibility of the person in the preparation and release of the document or the making of the public oral statement containing the misrepresentation or the ascertaining of the facts contained in that document or public oral statement, and
- In the case of a failure to make timely disclosure, the role and responsibility of the person involved in a decision not to disclose the material change.

## ENFORCEMENT OF INSIDER TRADING

- **Penal:** Under s.155(1)(b), this is a general offence with fine of no more than \$3mil. or 3 years in prison. Though under s. 155(5) there are additional fines on those who contravene of ss.57, 57.2 or 57.3.
- **Administrative:** Under s.161 (public interest) and s.162 (breaching any provision of Act), SecCom can issue a cease trade order, prevent one from being director or officer of any issuer; pull license of registered dealer; etc.
  - Under s.137, if SecCom or SH has reasonable grounds to think issuer has cause of action under s.136.1(1) but issuer has refused to pursue within 60 days written request by applicant, the Supreme Court can make an order authorizing the applicant to commence or continue an action under s.136.1(1)
  - Under ss.155.2-157 – SecCom, if it believes its in the public interest, can apply to the Supreme Court for an order to, CTO, prohibit from being D/O, de-license, remove any exemptions enjoyed, etc... even if s.155 has already been imposed.

## CIVIL LIABILITY FOR INSIDER TRADING

### **136 Liability for insider trading, tipping and recommending**

- (1) *If an issuer, or a person in a special relationship with an issuer, contravenes section 57.2, a person referred to in subsection (2) of this section has a right of action against the issuer or the person in a special relationship with the issuer.*
- (2) *A person may recover losses incurred in relation to a transaction involving a security of the issuer, or a related financial instrument of a security of the issuer, if the transaction was entered into during the period*
  - (a) *starting when the contravention occurred, and*
  - (b) *ending at the time the material fact or material change is generally disclosed.*
- (3) *If a court finds a person liable in an action under subsection (1), the amount payable to the PL by the person is the lesser of*
  - (a) *the losses incurred by the plaintiff, and*
  - (b) *an amount determined in accordance with the regulations.*
- (4) *For the purposes of subsection (1), in determining the losses incurred by a plaintiff, a court must not include an amount that the defendant proves is attributable to a change in the market price of the security that is unrelated to the material change or the material fact.*

### **136.1 Accounting for benefits**

- (1) *If a person is an insider, affiliate or associate of an issuer, and if the person contravenes section 57.2, the person must pay to the issuer an amount equal to*
  - (a) *the benefit that the person received as a result of the contravention, and*
  - (b) *the benefit that all persons received as a result of the contravention.*
- (2) *If a person contravenes section 57.3, the person must pay to the investor, as defined in that section, an amount equal to*
  - (a) *the benefit that the person received as a result of the contravention, and*
  - (b) *the benefit that all persons received as a result of the contravention.*

### **136.2 Due diligence defence for insider trading**

*A person is not liable under section 136 or 136.1 (1) if after a reasonable investigation occurring before the person*

- (a) *entered into the transaction,*
  - (b) *informed another person of the material fact or material change, or*
  - (c) *recommended or encouraged a transaction,*
- the person had no reasonable grounds to believe that the material fact or material change had not been generally disclosed.*

## CRIMINAL LIABILITY

### **22.1 Offences of negligence — organizations**

*In respect of an offence that requires the prosecution to prove negligence, an organization is a party to the offence if*

- (a) *acting within the scope of their authority*
  - (i) *one of its representatives is a party to the offence, or*
  - (ii) *two or more of its representatives engage in conduct, whether by act or omission, such that, if it had been the conduct of only one representative, that representative would have been a party to the offence; and*
- (b) *the senior officer who is responsible for the aspect of the organization's activities that is relevant to the offence departs ... markedly from the standard of care that, in the circumstances, could reasonably be expected to prevent a representative of the organization from being a party to the offence.*

**22.1 Other offences — organizations**

In respect of an offence that requires the prosecution to prove fault — other than negligence — an organization is a party to the offence if, with the intent at least in part to benefit the organization, one of its senior officers

- (a) acting within the scope of their authority, is a party to the offence;
- (b) having the mental state required to be a party to the offence and acting within the scope of their authority, directs the work of other representatives of the organization so that they do the act or make the omission specified in the offence; or
- (c) knowing that a representative of the organization is or is about to be a party to the offence, does not take all reasonable measures to stop them from being a party to the offence.

**380 Fraud**

(1) Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of this Act, defrauds the public or any person, whether ascertained or not, of any property, money or valuable security or any service,

(a) is guilty of an indictable offence and liable to a term of imprisonment not exceeding fourteen years, where the subject-matter of the offence is a testamentary instrument or the value of the subject-matter of the offence exceeds five thousand dollars; or

(b) is guilty

(i) of an indictable offence and is liable to imprisonment for a term not exceeding two years, or

(ii) of an offence punishable on summary conviction,

where the value of the subject-matter of the offence does not exceed five thousand dollars.

(2) Every one who, by deceit, falsehood or other fraudulent means, whether or not it is a false pretence within the meaning of this Act, with intent to defraud, affects the public market price of stocks, shares, merchandise or anything that is offered for sale to the public is guilty of an indictable offence and liable to imprisonment for a term not exceeding fourteen years.

**382 Fraudulent manipulation of stock exchange transactions**

Every one who, through the facility of a stock exchange, curb market or other market, with intent to create a false or misleading appearance of active public trading in a security or with intent to create a false or misleading appearance with respect to the market price of a security,

(a) effects a transaction in the security that involves no change in the beneficial ownership thereof,

(b) enters an order for the purchase of the security, knowing that an order of substantially the same size at substantially the same time and at substantially the same price for the sale of the security has been or will be entered by or for the same or different persons, or

(c) enters an order for the sale of the security, knowing that an order of substantially the same size at substantially the same time and at substantially the same price for the purchase of the security has been or will be entered by or for the same or different persons,

is guilty of an indictable offence and liable to imprisonment for a term not exceeding ten years.

**382.1 Prohibited insider trading**

(1) A person is guilty of an indictable offence and liable to imprisonment for a term not exceeding ten years who, directly or indirectly, buys or sells a security, knowingly using inside information that they

(a) possess by virtue of being a shareholder of the issuer of that security;

(b) possess by virtue of, or obtained in the course of, their business or professional relationship with that issuer;

(c) possess by virtue of, or obtained in the course of, a proposed takeover or reorganization of, or amalgamation, merger or similar business combination with, that issuer;

(d) possess by virtue of, or obtained in the course of, their employment, office, duties or occupation with that issuer or with a person referred to in paragraphs (a) to (c); or

(e) obtained from a person who possesses or obtained the information in a manner referred to in paragraphs (a) to (d).

(2) Except when necessary in the course of business, a person who knowingly conveys inside information that they possess or obtained in a manner referred to in subsection (1) to another person, knowing that there is a risk that the person will use the information to buy or sell, directly or indirectly, a security to which the information relates, or that they may convey the information to another person who may buy or sell such a security, is guilty of

(a) an indictable offence and liable to imprisonment for a term not exceeding five years; or

(b) an offence punishable on summary conviction.

(3) ...

(4) In this section, “inside information” means information relating to or affecting the issuer of a security or a security that they have issued, or are about to issue, that

(a) has not been generally disclosed; and

(b) could reasonably be expected to significantly affect the market price or value of a security of the issuer.

- The main difference is that the criminal provisions significantly increase jail time.
- In some ways, this catches more than the BCSA, because it: applies to any issuer (not just reporting issuer), catches persons that have “a connection” with an issuer (not just persons in special relationship)
- But good luck proving any of this with the added *mens rea* requirement and BARD standard.

## 463.8 ENFORCEMENT AND LIABILITY

- So, one can be liable under the Code and not *BCSA* or vice versa. For example Code might catch SH with less than 10% shareholdings and who doesn't otherwise fit in definition of special relationship.
- These may not be easy to enforce and not really effective but it serves following objectives:
  - Sending a signal that insider trading and fraud is unacceptable
  - The stigma attached and severe sentencing may lead to consents by offenders to imposition of regulatory sanctions under the provincial acts
  - Organizations would have incentive to implement compliance programs

### **Criminal Insider Trading Connection Test:**

- Not just the people in the special relationship with the issuer are liable, but anyone who possesses information:
  - As a SH; or
  - In course of their business; or
  - In course of proposed transaction; or
  - Due to employment, office, duties, occupation; or
  - From a person who possesses info in a manner referred to in a-d.

## INVESTIGATION AND ADMINISTRATION

### **BCSA GENERAL**

#### **15 Revenue and expenditure**

- (1) Revenue received under this Act, including but not limited to revenue from administrative penalties under section 162 and any cost recoveries under this Act, but not including revenue from fines referred to in section 155, must be paid to the commission.
- (2) Subject to subsection (3), money received by the commission may be expended for any costs involved in the administration and enforcement of this Act and for any costs involved in operating the commission.
- (3) Money received by the commission under section 155.1 (b), 157 (1) (b), 161 (1) (g) or 162 may be expended only for the purpose of educating securities market participants and members of the public about investing, financial matters or the operation or regulation of securities markets.
- (3.1) The commission may not expend money received under section 155.1 (b), 157 (1) (b) or 161(1) (g) unless the three years has expired.
- (5) This section applies despite section 12 of the Financial Administration Act.

#### **15.1 Claim for wrongful benefit**

- (1) The commission must notify the public in accordance with the regulations if the commission receives money from an order made under section 155.1 (b), 157 (1) (b) or 161 (1) (g).
- (2) A person that makes a claim to money held by the commission under this section must file the claim in the Supreme Court within 3 years from the date of the first notification made under subsection (1) and file a copy of the claim with the commission.
- (3) If the commission receives a copy of a claim under subsection (2), it must pay into court all of the money the commission receives from an order made under section 155.1 (b), 157 (1) (b) or 161 (1) (g).
- (5) After 3 years from the date of the first notification made under subsection (1), the commission may retain any money not claimed under subsection (2).

#### **57.5 Obstruction of justice**

- (1) A person must not
  - (a) destroy, conceal, withhold or refuse to give any information, or
  - (b) destroy, conceal, withhold or refuse to produce any record or thingreasonably required for a hearing, review, investigation, examination or inspection under this Act.
- (2) A person contravenes subsection (1) if the person knows or reasonably should know that a hearing, review, investigation, examination or inspection is to be conducted and the person takes any action referred to in subsection (1) before the hearing, review, investigation, examination or inspection.

#### **57.6 Duty to comply with undertaking**

A person that gives a written undertaking to the commission or the executive director must comply with the undertaking

### **BCSA PART 17: INVESTIGATION AND AUDITS**

#### **141 Provision of information to executive director**

- The executive director may make an order to provide information necessary to the investigation.

- He can also launch compliance reviews under ss.141.2-141.3

### ***142 Investigation order by commission***

- The commission may, by order, appoint a person to make an investigation the commission considers expedient

### ***143 Power of investigator***

- The powers of the investigator are very broad, and Charter protection does not really apply to any information gathered.
- But cannot go into the house without a court order

### ***144 Investigator's power to compel evidence***

- Investigator under s.142 has the power to compel evidence.
- Note that Charter does not really apply here.
- Crown cannot use evidence compelled by the SecCom as evidence in a criminal trial.

### ***150 Costs payable by person investigated***

- The commission may require a person whose affairs are investigated under this Part to pay prescribed fees or charges for the costs of the investigation.

## **BCSA PART 19: REVIEWS AND APPEALS**

### ***165 Review of Decision of Executive Director***

- SecCom can review any decision of executive director within 30 days of decision.
- Person affected can send in notice to SecCom and is entitled to hearing and review of decision
- SecCom can confirm or vary decision
- SecCom can stay the decision until review or hearing is complete

### ***166 Review of Decision of Person Acting under Delegated Authority***

- This applies to decisions made by people with delegated authority

### ***167 Appeal of Commission Decision***

- Person affected by decision of SecCom can appeal to Court of Appeal, with leave of such court.
- Court can stay decision until appeal disposed
- Court can order commission to make a decision or perform an act
- Even if the court has made a decision, if new information comes to light, SecCom can make a further decision
- SecCom is the respondent under for these appeals



## REGISTRANT REGULATION

**Registrant:** A very wide definition that covers all those who work in the financial industry, but not lawyers and accountants. This is highly regulated professional practice area. Some of the key players in the process are defined in the *BCSA*.

**Dealer:** A person who trades in securities or exchange contracts as principal or agent. Difference between broker and dealers is pretty technical, where broker merely matches the buyers and sellers, and dealer is one who buys them for himself to resell. In Canada we have broker/dealers packed in one *BCSA* definition.

**Salesperson:** An individual employed by a dealer to make trades on the dealer's behalf in securities, exchange contracts or both.

**Advisor:** A person engaging in, or holding himself, herself or itself out as engaging in, the business of advising another with respect to investment in or the purchase or sale of securities or exchange contracts.

**Portfolio Manager:** An adviser who manages the investment portfolio of clients through discretionary authority granted by one or more clients.

**BCSA PARTS 5 – 7****34 Persons who must be registered**

*A person must not*

- (a) trade in a security or exchange contract,
- (b) act as an adviser,
- (c) act as an investment fund manager, or
- (d) act as an underwriter,

*unless the person is registered in accordance with the regulations and in the category prescribed for the purpose of the activity.*

- The SecCom must grant an applicant registration as per s.35, unless if SecCom considers that the applicant is not suitable in the capacity, or just an objectionable person in general. This can be challenged with an opportunity to be heard.
- In s.36, SecCom can impose certain conditions to the registration.
- Further info may be required under s.38
- If the registrant is fired, then their registration is also suspended under s.40
- Of course as per s.48 SecCom also has the power to make exemptions to any of the above, as long as it is not against public interest.

**49 Calling at or telephoning residence**

*(2) A person must not*

- (a) attend at any residence, or
- (b) telephone from inside British Columbia to any residence inside or outside British Columbia

*for the purpose of trading in a security or exchange contract.*

**50 Representations prohibited**

*(1) A person, while engaging in investor relations activities or with the intention of effecting a trade in a security, must not do any of the following:*

- (a) represent that the person or another person will
  - (i) resell or repurchase the security, or
  - (ii) refund all or any of the purchase price of the security;
- (b) give an undertaking relating to the future value or price of the security;
- (c) represent, without obtaining the prior written permission of the executive director,
  - (i) that the security will be listed and posted for trading on an exchange or quoted on any quotation and trade reporting system, or
  - (ii) that application has been or will be made to list and post the security for trading on an exchange or quote the security on any quotation and trade reporting system;
- (d) make a statement that the person knows, or ought reasonably to know, is a misrepresentation;
- (e) engage in an unfair practice.

*(4) For the purposes of this section, an "unfair practice" includes any of the following:*

- (a) putting unreasonable pressure on a person to purchase, hold or sell a security;
- (b) taking advantage of the person's inability or incapacity to reasonably protect his or her own interest because of physical or mental infirmity, ignorance, illiteracy, age or inability to understand the character, nature or language of any matter relating to a decision to purchase, hold or sell a security;

(c) imposing terms or conditions that make a transaction inequitable.

- Bottom line is that you can't promise outrageous crap to gullible boobs.

### **51 Registered dealer acting as principal**

(2) If a registered dealer

(a) intends, as principal, to effect a trade in a security with a person who is not a registered dealer, and

(b) issues, publishes or sends a notice, circular, pamphlet, letter, advertisement, telegram or some other record to that person to effect that trade,

the registered dealer must not contract for the sale or purchase of the security unless, before contracting and before accepting payment or receiving any security or other consideration under or in anticipation of the contract, the registered dealer has stated in the record referred to in paragraph (b) that the registered dealer proposes to act as principal in the trade.

### **52 Disclosure of investor relations activities**

- If someone is selling your shit on your behalf, you must disclose this to any person who inquires.
- This applies to every record disseminated in the process of the aforementioned shit-selling.
- Some of the following sections are pretty self evident:
- Under s.53 a registrant should not use the name of another registrant on letterheads and such, unless authorized.
- As per s.54, one must not represent that they are registered under the Act, unless if they are, and they specify under which section.
- When short-selling, one must declare that they are short selling (that is, they are not the owner of the security).

### **57 Manipulation and fraud**

A person must not, directly or indirectly, engage in or participate in conduct relating to securities or exchange contracts if the person knows, or reasonably should know, that the conduct

(a) results in or contributes to a misleading appearance of trading activity in, or an artificial price for, a security or exchange contract, or

(b) perpetrates a fraud on any person.

- Well there goes my career plan.

## **NI 31-103: REGISTRATION REQUIREMENTS AND EXEMPTIONS**

- Part 2
  - Individuals have to be registered as either: ...
  - But for those who work in the firm, individual registration is contingent on the firm registration - thus one who loses their firm position has their individual registration suspended.
- Part 5
  - 5.1
  - 5.2
- Part 7 Categories of registration for firms
  - 7.1 and 7.2 definitions of who different dealers and advisors are.
  - Sometimes its needed to be registered as both
  - Exempt market dealers are now registrants
- Part 8
  - Northwest exemption? WTF?
  - 8.4
  - 8.10
  - 8.18
  - 8.21
- Part 9 Membership in a self-regulatory organization
  - An investment dealer must be a member of IIROC
  - Mutual fund dealers must be members of MFDA
  - Under 9.3 there are some exemptions to the above.
  - An investment dealer firm will largely be reporting to IIROC as their regulator, dealing with SecComs only when things go sour.
  - But SecComs will be dealing with advisers.
- Part 11 Internal controls and systems

## 463.9 REGISTRANT REGULATION

- 11.1
- 11.4
- 11.5
- Part 12 Financial condition
  - Different requirements for different registrants
  - Insurance and bonding - self explanatory
  - IIROC compensation fund
- Part 13
  - These are very important now
  - 13.2
  - 13.3

### Registration requirements:

- Proficiency - exam based requirement
- Capital - there must be enough capital on hand to meet claims and liability

### Guest lecture notes:

- Note that in ON there is no offering memo exception
- In the west we used to be ok allowing this exception based on the twin rationale of sophisticated investor and the warning on the offering memo - thus lack of registration for EMDs.
- But this is changing?
- BCI 32-517
- Look at FSA ban for product manufacturers paying to the distributors.