

LAW 613(X5)

CORPORATE SECURITY
AND FINANCE

CHAMBERLAIN

PART I: INTRODUCTION

(A)—Sources of Securities Law

- **Securities Act and Regulations (Rules)** are the main source of Securities Law:
 - Pursuant to the *Securities Act*, a Provincial Securities Commission now has the ability to make 2 kinds of Rules: **instruments** and **regulations**. **These Rules are adopted by the Legislature; therefore, they have force of law**. Ex. Instruments and Regulations made by AB Securities Commission only apply in AB.
 - **National Instruments: a policy adopted by every Securities Commission in the country**. The Canadian Securities Administrators (CSA) is a self regulatory body made up of every provincial securities commission who adopt and create national policies → requires unanimous approval. These National Policies are known as National Instruments --it is effectively like a Federal Law cuz it applies everywhere in Canada. Ex. a local AB Rule and National Instrument may both apply in a transaction.
 - **Multilateral Instruments**: instruments adopted by 2 or more jurisdictions but not every province. So they will have force of law in some jurisdictions but not all.
 - Securities commissions also legislate thru **Blanket Orders**:
 - Commission has power to grant **discretionary orders (relief)** where it is in the public interest to do so. Company wants to do something that does not quite fit within any of the Rules, they can make an application to securities commission who will then issue this exemptive relief (these regulations don't apply so long as you do this and this) = Commission can bend the Rules.
 - Every once and while the Commission releases a **blanket order** (no one applied for it--did it on their initiative): **if you can meet these exceptions then this exemption applies to you**. Blanket order is issued under the Securities Act so it is law as opposed to a Policy.
- **Guidelines = no force of law**
 - **Local Policies**: the Securities Commission often issues 'Policies'. They include guidelines, instructions and interpretations that sometimes take on a regulatory framework. The 'Policies' are very flexible, but do NOT have force of law. There are 2 types:
 - **Companion**: adjunct to a particular Rule that has been adopted (this is how we are going to interpret this Rule)
 - **Stand Alone**: a policy that is not connected to any Rule in particular
 - **National Policies**: same principle as Local Policies. There are Companion (this is how we are going to interpret this National Instrument) and Stand Alone policies. These are NOT law.
 - **Notices**: can be issued locally or by CSA. It is an informal newsletter intended to give guidance and information.
 - **Uniform Act Policies**: a number of provinces' Securities Act's are modelled after the old Uniform Act. There is only policy remaining which only applies to provinces who are modelled after this old Act.
- **Other Sources**: It is important to know where you are on the chart: first 2 lines are law. 3 and 4th lines are policies but not laws (just persuasive).
 - **Stock Exchange Rules and Policies**:
 - Each stock exchange has its own set of rules and policies that you have to comply with in order to be publically traded. This is NOT law, but in order to get on their exchange you have to play ball.
 - In Canada we have 3 exchanges:
 - TSX Venture Exchange (TSXV): this is what we have in AB and BC. It is based in Calgary and Vancouver. It is a subsidiary of a company called TMX. TMX also TSX
 - TSX (Toronto Stock Exchange) or TSE
 - CNSX (Canadian Stock Exchange): independent and small.
 - **Corporate (or other) law**:
 - If you are issuing securities you are likely a corporation (could be a partnership or income trust). There is legislation that governs conduct of corporations. Corp wants to issue shares, under corporate law what does it have to do.

Overall: you must consider ALL the sources of law. You cannot assume because you find applicable law in one place that it isn't modified in another place

(B)—The Closed System--Securities Regulatory System

- All prov have **Closed Systems** except for MB (has open system).
- Closed system creates a box. Every company starts inside this box. Inside the box is **restricted trading** (if company wants to issue and sell shares they cannot because they are in the restricted trading box).
- **Getting out of the Closed System:**
 - Big front door called **Registration—registration is accomplished by filing a Prospectus for the shares you want to issue.** Must be filed with and approved by securities commission. If I've done that, I can get my shares out of the box and into the free trading world.
 - If I am an individual, I must register as a stock broker. Can't sell securities unless you are a registered stock broker.
 - Back Door out of the box = **exemptions from the Registration requirements.** Bulk of activity takes place here. You don't immediately get out of the box with an exemption, you must wait. One of the triggers before you get out is filing a prospectus; thus you can't get out the back door without filing a prospectus.
- **Continuous disclosure requirements** – once you are out of the closed system, then the company must comply with continuous disclosure requirements to stay out of the box.

(C)-Terms and Definitions

- Securities Act is an act of general application, it applies to any corporation that was incorporated on an Indian Reserve; therefore, a corporation on a reserve must comply with securities legislation--can't escape securities requirements by incorporating on a reserve.
- "Means" vs. "includes the following":
 - Means: that is the term and nothing else. It is an exclusive defn
 - Includes: not an exhaustive defn, other things may fall within this defn--room to expand.

"issuer"

means a person or company that

(i) has outstanding securities,

(ii) is issuing securities, or

(iii) proposes to issue securities.

- Securities Act does not talk about corporations, it talks about issuers. Ex. A corp issues shares of itself (bylaws states that it can). A partnership issues partnership units = an issuer. An income trust creates trust units = issuer. An individual can be an issuer, I issue an iou, this is a security and I become an issuer.
- Anyone or anything can be an issuer.

"security" includes:

(i) Shares (regardless of type or class)

(ii) any bond, debenture, note or other **evidence of indebtedness**

- I.O.U. or loan agreement is an evidence of indebtedness
- Bond = promissory note (this company owes another company a certain amount of money). Bond and debentures are the same thing.
- Coupon: a bond principal + interest rate. Each coupon pays the holder a certain sum of interest before bond matures. People would sometimes clip coupons and keep them instead of redeeming them and sell bond principal for less than actual value to get some cash immediately.
- Stripped bond: all the interest payments were stripped off--so you only get the face amount (the principal bond amount)

(iii) any document constituting evidence of an **option, subscription** or other interest in or to a security;

- **Subscription to a security:** X goes to corporation and says I want to buy 100 shares for you for \$100. If corp agrees then this is a subscription agreement and it constitutes a security. Doesn't matter if you never issued the shares, if you accepted the subscription agreement that he will buy then it is a share.
- **Option = the right to acquire something**--give someone the option of buying shares in the future→ this is a security. Ex. Write me a chq for \$100 and you can have an option to buy shares at this rate for 1 year.
- Option vs ROFR: option forces issuer to sell the shares at the set rate; ROFR does not force issuer to sell the shares, rather if issuer decides to sell them, before issuer sells them to somebody else issuer has to go to X and ask X if he wants them (get first crack). Option is compulsory to sell, a ROFR is not.
- **Different types of options:**
 - **Put: an option to sell something.** If I own the right to put shares to you at a set price (here are my shares I want my money now) then I can force you to buy them from me. Ex. Bet the stock price is going to go down--sell it to them a higher price than the market price.
 - **Call: an option to purchase.** If I own a call option that X has sold to me, I can call upon X to sell me the shares at the agreed upon price. Ex. Bet the stock price will go up.
 - **Share Purchase Warrant: an option to buy a share/security and a warrant.**
 - **A Warrant is sold in connection with another security bundled together in what is known as a unit offering.** Ex. I am selling shares in my company, I will offer you 100 shares for \$1 and I will also give you 100 warrants to buy more shares at a fixed price (locked in at that price--added incentive for you to invest in the company--stock will go up--typically to buy warrant will be more than what the share cost). A warrant is typically transferrable. A warrant has a medium term typically (around 2 years).
 - Piggy back warrant: not offered in companies listed on the exchange. If you exercise warrant, you get a share + another warrant.
 - B Warrants (broker): warrant granted to a stock broker, compensation for doing an underwriting.
 - **Incentive stock option:** awarded to employees, directors, officers of a company. Give them an option to purchase a certain amount of shares at a certain price. These options are not transferrable. Term is typically 5 years. Some have vesting restrictions--the entitlement to exercise it will be subject to conditions (option on a 100K of shares, but I can't exercise at all the first year, 2nd year I can exercise (buy) 20,000, 3rd year another 20K, etc.).
 - **Share appreciation right** (another type of incentive option) aka SAR: a SAR works the same as an option, but it has a cashless exercise feature. Ex. I have an option to buy a 100K of shares, exercise price for that option is a \$1 per share, 1 year goes by, now the share is worth \$2 a share, I can write a chq for 100K and then immediately turn around and sell them for \$2 a share and make a 100K profit. If you don't have 100K to cut a chq like that, then the company can pretend that you cut a chq for 100K and you took that profit and bought the same shares with it at the market price--I made a 100K profit, that would give me 50,000 shares--so the company basically gives you 50,000 shares for free and your option is cancelled. SAR sets a formula--when you trigger your SAR it will trigger this cashless exercise feature and you will get shares not money.

(iv) any agreement under which money received will be repaid or treated as a subscription to shares, stock, units or interests at the option of the recipient or of any person or company;

- Ex. I give you money and you will convert it into shares, this is a combination of a subscription and an option. I got some land and I'll develop it if you give me money and will split the profits 50/50.

(v) any profit-sharing agreement or certificate;

- Any right to participate in the profits of something is a security--this is a royalty.

(vi) any oil or natural gas royalties or leases or fractional or other interest in them;

- Entitlement to a royalty is a security.

(vii) any document, instrument or writing **commonly known as a security;**

(viii) any investment contract

- This is not defined in the Act or regulations. Have to look at case law to get a defn.

- This is used as a catch-all—people don't want to be regulated by Securities Act, they will structure a deal to avoid it, this section is used as a catch-all to classify the deal as a security = regulations apply.

Investment Contract—there are 2 Tests we can use

TEST 1: *SEC v. W. J. Howey* (1946) (US)

- Guy owned orange grove, wanted people to invest in his business, but he didn't want to file a prospectus, so he sold them a strip of land with a row of orange trees on it and you will hire me to harvest the orange trees, and then I will give you a share of the profits based on how many orange trees you own.
- SEC says this is selling a security. Does this arrangement constitute an investment contract?
- **3 part Investment Contract TEST (must satisfy all 3 criteria):**
 - (i) contract or transaction where a person invests with an intention to earn a profit**
 - Investment does not have to be money, just has to be something of value (like land)
 - (ii) investment in a common enterprise**
 - Farmer picks oranges from all the trees, pools them together and then sells them. All of the owners were pooled together in a common enterprise; farmer did not go to all the trees of owner X and sell those individually to the factory. Rather, everyone's oranges were pooled together and sold together.
 - Common enterprise can be horizontal (profit shared among investors) or vertical (profit shared among investors and promoter)
 - (iii) the person is led to expect profits solely from the efforts of a promoter or third party**
 - Owner is not going to pick weeds around his orange trees; rather, farmer will do it for me. Whether I make money or not will depend on his efforts.
 - "Solely"--this has been watered down to significant.
 - *Williamson v. Tucker* (1981) (US 5th circuit)--this case sets out a 3 part test to determine if the investors will be relying on the efforts of a manager/promoter—but only one element has to be satisfied—1 yes = reliance on the promoter:
 - (a) the agreement leaves **little** legal power in the hands of the investors (legal test),
 - Ex. Right to vote on any decisions made, right to any input in the operations
 - (b) the investors are inexperienced or unknowledgeable and, in consequence, incapable of exercising management powers (practical test); or
 - Even if I could get other tree owners to vote farmer out with me, there is no way I can go down and take care of the trees--I don't have an ability to exercise management powers.
 - (c) investor is dependent on unique managerial abilities of the manager (practical test).
 - Does promoter have special skills that I can't replace--is he an expert in growing orange trees? This isn't about how much I know, but rather his unique abilities.

Test 2: *State Commissioner of Securities v. Hawaii Market Center Inc.* (1971)(US)—Hawaii Test—Risk Capital Test: this case creates a **4 part test** for determining if there is an investment contract:

(i) investor furnishes initial value

- Just like first part of Howey test.

(ii) a portion of this value is subject to risks of the enterprise

- Is there a risk associated with this investment, can investor lose some of his money

(iii) investment is induced by a promise leading to a reasonable expectation that a benefit will accrue

(iv) investor does not have right to exercise practical and actual control over management

- Investor is relying on promoter
- Hawaii test does NOT require a common enterprise. If there is no common enterprise, then use the Hawaii test to get the transaction determined as investment K.
- Howey and Hawaii Tests are both law in Canada--both have been adopted by SCC in *Pacific Coast Coin Exchange v. Ontario Securities Commission*. And they watered down the "solely" language of Howey.

Re Land Development Company Inc. and Phil Archer (AB SEC, 2000)

- AB Securities Commission adopted both tests in this case.

- Majority: In determining if something is a security, form should be disregarded for substance, emphasis should be placed on economic reality. Take a broad approach to determine if the transaction is a security.
- Dissent: take a broad look at security defn, take reality into account but don't be overbroad and catch everything. This will slow down business.
- FACTS: Phil set up a company to develop land (164 acres). However, he needed to raise \$ for the development so he sold parcels of the land in a manner he thought would avoid securities act. He sold one acre lots to investors, upon which they would sign a co-ownership agreement stating: "they wouldn't take possession, and that land was to remain pooled and Phil would develop it and then in return they would get a portion of profits. Note: there was no sale of specific acre lots, rather he sold them undivided interests (UDI). UDI = investor does not get 1 particular acre that is his, rather investor owns 1/164 acre of the entire plot of land. So all the money is pooled together and no one owns specific acres.
- **Issue:** Was this a transaction that fell under regulations of Securities Act?
- **Decision: Yes, this was an investment K pursuant to the Howey Test:**
 - Invests with intention to earn profit—yes.
 - Investment in a common enterprise
 - Not buying a particular acre; rather just a UDI. When you sell part of the land, you are selling a piece of everyone's investment. Therefore, it is pooled. When land was sold, all profit would be doled to everyone on a proportionate interest basis (horizontal commonality between investors)
 - Vertical commonality between investors and Archer: they are all trying to make a profit together
 - The person is led to expect profits solely on the efforts of the promoter (Archer)
 - Archer said he would take care of everything; investor did nothing.
 - *Williamson v. Tucker* test:
 - Legal test: Investors had the right to vote, but only if they were asked to vote on something by Archer. So they had no legal power in the management of the project. Could they remove Archer? Yes, but only if they had just cause. So investors had very little legal power in their hands.
 - Inexperienced or unknowledgeable: experienced in general business matters or specifically land development. The commission could not conclude that all investors were experienced. Therefore, Commission held that the investors were inexperienced.
 - Unique: Archer held himself as an expert and investment was structured in a way that no one would want to take over cuz he already took out all the profit--he made himself irreplaceable. Therefore this is satisfied too.
 - So all 3 tests are satisfied even though we only need one.

We know what a security is now, so what is a Trade:

"trade" includes

(i) **any sale or disposition of a security for valuable consideration** (gift isn't a trade), whether the terms of payment are on margin, instalment or otherwise, **but does not include**

(A) **a purchase of a security, or**

(B) except as provided in subclause (v), a transfer, pledge or encumbrance of securities for the purpose of giving collateral for a bona fide debt;

- Sale or disposition: whether seller gets paid up front or later does not make any difference.
- Securities Act regulates the sale of the security, but not the purchaser buying. Critical aspect is the sale, as purchase is not included. Ex. In *Land Developments* when Archer sold those lots he was trading in securities; but when the investors bought them they were not trading. **Only those trading in securities will be regulated & subject to penalties and sanctions.**
- Excludes pledging security for bona fide debt: I have shares in a company and I want to get a loan from a bank--bank holds them in security, this is NOT a trade, just pledging them. Exception if the pledging is done by a control person.

(ii) any entering into a futures contract or an option that is an exchange contract;

(iii) any participation as a trader in any transaction in a security or an exchange contract through the facilities of an exchange or a quotation and trade reporting system;

(iv) any receipt by a registrant of an order to buy or sell a security or an exchange contract;

(v) any transfer, pledge or encumbering of securities of an issuer from the holdings of a control person for the purpose of giving collateral for a bona fide debt;

(vi) any act, advertisement, solicitation, conduct or negotiation made directly or indirectly in furtherance of anything (a trade) referred to in subclauses (i) to (v).

- If X calls someone and asks them to buy shares, then this phone call is an act in furtherance of trade and is therefore a trade (doesn't matter if a trade did not take place. In order to trade, the seller must be a registered broker.

"control person"

means any person or company that holds or is one of a combination of persons or companies that holds

(i) a sufficient number of any of the securities of an issuer so as to affect materially the control of that issuer, or

(ii) more than 20% of the outstanding voting securities of an issuer except where there is evidence showing that the holding of those securities does not affect materially the control of that issuer;

- At 20% you are deemed to have control unless you can prove that you don't affect control
- Private company: need to have 51% of the shares
- Public company: don't necessarily need 51% to affect control.
- Sufficient number: Can be a control person at less than 20% too. ex. Everyone else only owns 1 share, chances of everyone getting together and outvoting me is small if I have 10%.

"distribution"

when used in relation to trading in securities, means

(i) a trade in securities of an issuer that have not been previously issued,

- Corporation is created, it has an authorized share capital of X common shares, but they have not been issued, they are still in the company's treasury. Corp then issues to Z 100 common shares--issued them out of their treasury, those shares had not been previously issued; therefore this is a distribution.

(ii) a trade by or on behalf of an issuer in previously issued securities of that issuer that have been redeemed or purchased by or donated to that issuer,

- If a corp buys back some of its shares (redeems) and then re-sells them, this is a distribution.

(iii) a trade in previously issued securities of an issuer from the holdings of a control person,

- Trade is the sale of a security. Doesn't matter who is selling.
- Distribution is a trade of an unissued security. **Therefore, every distribution will always be a trade, but a trade will not always be a distribution.**
- Ex. Corp sold them to Z from the treasury = both a trade and a distribution.
- To trade you must be registered; therefore you must be a stock broker.
- To distribute securities you must file a prospectus
- Z wants Y to be a 50/50 partner, 2 ways this can happen:
 - Z can take half of her shares and sell them to Y. This is a trade (sale of shares). This is not a distribution cuz they are not unissued shares (not new shares coming out of treasury). **But Z owns 100% of the shares of the company, so Z is a control person, and a trade of previously issued certificates from a control person is a distribution. Therefore, it is a distribution.**
 - Z keeps his 100 shares and company could issue 100 shares to Y: this is a trade and a distribution.

(iv) a trade by or on behalf of an underwriter in securities that were acquired by that underwriter, acting as underwriter, prior to February 1, 1982 if those securities continue on February 1, 1982 to be owned by or for that underwriter, so acting,

(v) a distribution referred to under the regulations (this trade will be a distribution even though normally it wouldn't be),

(vi) a trade or an intended trade deemed to be a distribution under section 144(2), or

- Securities commission can deem something to be a distribution.

(vii) a transaction or series of transactions involving a purchase and sale or a repurchase and resale in the course of or incidental to a distribution referred to in subclauses (i) to (v).

s.2.4 of NI 45-106 “private issuer”

means an issuer

(1) that is not a reporting issuer or an investment fund (like a mutual fund),

(2) whose securities (except non-convertible debt):

a) are subject to **transfer restriction contained** in the **issuers constating documents** (docs that constitute the corp--articles of corp and bylaws) or security holders’ agreement; **and**

- Ex. of restriction, any transfer of shares requires approval of the directors

b) are owned by not more than 50 people, exclusive of employees and former employees, **and**

(3) has only distributed designated securities to the permitted list of investors [i.e. relatives, close friends, accredited investors – s. 2.4(2)].

- Private issuers avoid securities act and regulations. Private issuer must satisfy all 3 elements here.
- Private issuer is in the closed system.

“reporting issuer” (opposite of private issuer)

Means an issuer

(i) that has filed a prospectus and obtained a receipt for it (approval by securities commission) = you are a reporting issuer, **or**

(ii) that has shares listed on a stock exchange recognized for that purpose (TSX Venture Exchange), or

(iii) That has exchanged its securities in an amalgamation, arrangement or similar transaction with a reporting issuer, or

- one of the companies was a reporting issuer and one was a private issuer, the surviving issuer will be a reporting issuer

(iv) that is declared to be a reporting issuer by order of the Commission.

- 2 reasons why being a reporting issuer is important:
 - Reporting issuer is subject to continuous disclosure obligations
 - Financial statements, information circulars, material changes. If you are not a reporting issuer you don't have these obligations
 - This gets you out of the closed system--this allows shareholders to buy and sell my shares freely.

The ABCA states that “Distributing Corporation” means a reporting issuer in the Securities Act. Thus, if you are a reporting issuer in AB then you are also a distributing corporation. This is important because there are some additional ABCA requirements that apply. ex. obligation to have audit committee, proxies.

- A corporation may have more than 50 s/h so they are not a private issuer and this same corporation may not be a reporting issuer because they have not filed a prospectus. So a corp can be neither--in the grey zone. And the grey zone is in the closed system. Only way out is to be a reporting issuer.

“insider” means

(i) every director or officer of the issuer

(ii) every director or officer of another issuer that is, itself, an insider of the issuer

(iii) every subsidiary of the issuer (and directors and officers of the subsidiary are insiders too)

(iv) every person or company who beneficially owns, directly or indirectly, or exercises control or direction over securities carrying more than 10% of the outstanding voting rights of the issuer

(v) the reporting issuer itself if it holds any uncanceled securities in itself (buys back some of its own shares that it has not cancelled yet; can't hold your own shares unless you are holding them on trust)

(vi) Someone designated an insider by an order of the Commission.

- This defn is important for insider reporting requirements.

Directors are appointed by the shareholders. Directors choose officers.

“officer”

Means a chair or vice-chair of the board of directors, chief executive officer, Chief operating officer, chief financial officer, president, vice-president, secretary, assistant secretary, treasurer, assistant treasurer and general manager of a company or any other individual who performs functions for an issuer similar to those performed by an individual occupying that office, and an individual that is designated as an officer under the by-laws.

- Substance over form, actual role and not job title that is important.
- If bylaw designates someone as an officer they are an officer for the Securities Act.

"promoter"

means a person or company that

(i) alone or in conjunction with others, takes the initiative in founding, organizing or substantially reorganizing the business of an issuer (founders of the company = promoter), or

(ii) in connection with the founding of the issuer, in consideration for property or services, receives 10% or more of any class of securities or 10% or more of the proceeds from a particular issue of securities.

- Certain docs require corp to disclose who the promoters are. Promoters must sign and certify certain docs.

"material change" means

(i) a change in the business, operations or capital of the issuer that would **reasonably be expected to have a significant effect** on the market price or value of any of the securities of the issuer, **or**

- If we announce a change, will it cause the stock price to move up or down in a material way.
- Materiality is the key test to disclosure in Securities Act. **This is the materiality test.**

(ii) a decision to implement the change made by the board of directors or by senior management who believe that confirmation of the decision by the board of directors is probable.

- Decision to implement a material change (hasn't been done yet) is itself a material change.

"registrant"

means a person registered or **required** to be registered under the Act.

- To trade in a security you must be registered. Therefore, anyone trading must be a registrant.

"SEDAR"--System for Electronic Document Analysis and Retrieval. Most docs filed with securities commission is filed with SEDAR. "SEDI"--System for Electronic Disclosure by Insiders. Insiders of companies use this to file their insider reports.

PART II: PROSPECTUS – GOING PUBLIC

CH 1: CONCEPTS AND PROCESS

(A)---Reasons to go Public (get out of the closed system)

- **Raise money:**
 - When a company gets out of the closed system this means its s/h can be bought and sold—people invest money in company.
 - Being public allows corps shares to be a **liquid** investment → ability to buy and sell shares as investor sees fit (there is a market for them). **Going public allows you to raise money cuz the shares are liquid**
- **Exit Strategy**
 - s/h can dispose of the asset if he wants. If he couldn't then it is not a very attractive asset. Investors like to know how they can get out of an investment-->exit strategy.
 - Allows s/h to get a return for the money raised—they are transferrable.
 - This liquid investment helps you raise money cuz it is liquid and there is an exit strategy.
- **Getting traditional debt financing is easier for public company than a private company**
 - Go to bank and get a loan. Public companies have a lot of financial info out there--it is easy for bank to find out about company and monitor the security for the debt.

- Also, Public company has greater ability to pay the lender back.
- Also, public companies tend to be more stable—going public can be seen as a seal of approval.
- **Easier to sell off a portion of a public co** - private companies usually have to be sold in their entirety. Liquidity provides an exit strategy for the owner of a co.—easy to liquidate it all or some of it.
- **Good collateral for loan**
 - Pledge your public shares for collateral as a loan. Lenders don't want shares from a private company.
- **Easier to Maintain Control of Company:**
 - In a private company, you need 51% of the shares to have control. In a public company, deemed if you own more than 20%. Easier to be the majority control person in a public company.
- **Shares can be used as currency** – can takeover another co, and instead of having to use valuable cash, you can issue shares to the vendor co, who can then sell the shares on the open market. You can buy other companies using stock instead of cash.
- **Employee Incentives** – Liquidity permits the company to benefit EEs through ownership interests – great motivator. This is also a form of preserving cash – can issue options instead of a higher salary.

Costs of Going Public

- **Expensive:** legal, accounting and brokerage fees. Not just a one time cost but continuous disclosure requirements (audits, news releases, shareholder meetings).
- **Management time:** top guys use up some time to meet these continuous disclosure requirements.
- **Fish Bowl Effect:** Once public you are living in a fishbowl and everyone has an opportunity to look inside your company – could cost you a competitive edge. If you have to make public information about your sales revenues and net income a competitor can see your margin and may be able to out bid you. SEDAR – competitors will see your competitive info (margins), customers and suppliers will see your business information (are u close to bankruptcy?).
- **Tax Implications:** CCPC (Canadian Controlled Private Corporation)--pay a low tax rate on first 500K. But if you are a public company you are no longer a CCPC and not entitled to that tax benefit.
- **Restrictions on how you conduct your business.** If you are a one person operation and you want to do something it happens. Public company--officers have to talk to directors and directors have to talk to s/h.
- **Stock exchanges rules:** costs to get approval and reporting and auditing requirements.
- **Greater potential for liability** b/c more rules to follow for public companies and regulators and shareholders are watching your actions.
- **One Way Street** – once you go public and become a reporting issuer, you cannot go back to being private. You have to get approval from the SC to undo the process and approval will not be granted if you have public shareholders. The only way to go private once you are public is to buy back the shares at a price that all the shareholders will accept and this is very difficult if not impossible.

(B)—The Process

- **110(1) No person or company shall trade in a security** on the person's or company's own account or on behalf of any other person or company **if the trade would be a distribution of the security unless**
 - a preliminary prospectus has been filed and the Executive Director has issued a receipt for it, **and**
 - a prospectus has been filed and the Executive Director has issued a receipt for it.
- No one can trade in securities where that trade would be a distribution (sale of securities that were not previously issued) unless (1) filed and been issued a receipt for a preliminary prospectus and (2) file and receive a receipt for a prospectus.
 - Think of "prospectus" as a "final prospectus".
 - Receipt = approval--a receipt will be granted when the prospectus is approved by the SC.
 - Receipt for prelim is called a decision document.

1st Step--File a Preliminary Prospectus

- What is this: it is a good draft of final prospectus--the next to final version before it is completed. **It is a disclosure doc that tells the public information about the company (ex. Financial statements, directors, etc.).**
- Must contain the same information as final prospectus except for certain items the Act allows you to leave out:

- **s.111(2): auditors report may be omitted:**
 - In a preliminary prospectus you are allowed to omit audit report which would ordinarily appear at beginning of prospectus. However, standard practice is not to omit it but include it in a draft unsigned form. Reason it is not signed is b/c includes offering price which is not finalized until prospectus is finalized. Instead of signing auditors provide a **Comfort Letter** or a **NEGATIVE ASSURANCE LETTER** which indicates that financial statements have been correctly prepared and are ready to be signed, yet signing will be postponed until the ASC suggests any amendments.
 - GAAP--generally accepted accounting practices: set of rules accountant follows when reviewing financial statements.
- **s.111(2) – Allowed omissions of preliminary prospectus--(2) The report or reports of the auditor or accountant required by the regulations and any information with respect to**
 - (a) the price to the underwriter
 - (b) the offering price of any securities (although with most IPOs this will be included b/c it has likely been negotiated with a broker ahead of time), and
 - (c) matters dependent upon or relating to those prices (such as the total number of shares to be issued),

may be omitted from a preliminary prospectus.

 - Can omit info relating to or depending on the pricing of the offering. This impacts how many shares you want to sell in order to raise the 10 million. So info wrt pricing and how many shares may be missing.
- **A prelim is required to include a red herring (Prospectus Warning and Disclaimer Clause)**
 - s.1.2 of Form 41: warning on front page of prelim that says--"this is only a prelim it is NOT final, it has not been approved by SC, can't use it to sell securities". It must be italicized and in red ink.
- **One doc that must be filed with prelim is a personal information form (PIF)**
 - PIF must be completed by every officer, director and promoter of the issuer. It asks personal info (name, address, citizenship, previous criminal convictions, bankruptcies, etc.). Get full disclosure of your personal background so they can assess whether you are a suitable person to be running a public company.
- **s.123(c): prelim can only be used to obtain expressions of interest –it can NOT be used to sell securities.** If prelim is given to customers, broker must take their name and address and must provide them the final when they get it.
- **Once you file prelim, if it is in the required form and it is accompanied by required docs (ex. comfort letter) then the SC does NOT have discretion to refuse to issue a receipt for a prelim (if it meets the requirements they must issue a receipt).** It can only refuse to issue a receipt if you have NOT complied with all the requirements for a prelim.

The Clearing/Vetting Process

s. 113 – A prospectus shall

- (a) provide full, true and plain disclosure of all material facts relating to the securities proposed to be issued or distributed, and
- (b) comply with the requirements of the Alberta securities laws

After filing of preliminary prospectus we have **VETTING PROCESS** - During the time b/n the issuance of a receipt for the preliminary prospectus and the issuance of a receipt for the final prospectus, the ASC will make recommendations/suggest any changes (**issue a comment letter**). Once necessary revisions have been made, the ASC invites you to file a final prospectus; assuming all revisions are satisfactory, you will be issued a final prospectus and can then go on to sell the securities pursuant to the terms of the prospectus.

Technical Aspects of Prospectus Filing Process

- It is done electronically thru SEDAR--prelim, docs that must be accompanied, prospectus. Select commissions you are filing with.
- Some docs have to be signed, but SC does not want scanned docs, so docs say on signature line "signed by John Doe". If you do this, you are certifying that you are in possession of the signed doc and have authority to file on behalf of the people who signed. You file SEDAR Form 6 which states that "I signed prospectus and authorized this filing" and then this is the only one that is signed.
- When you file final, one of the docs that must accompany is a black line or red lined--shows all the changes that have been made from prelim to final.

Filing in More than One Jurisdiction

- Prelim is filed under NI 41-101; therefore, the requirements will be the same whether you are filing in one or many jurisdictions cuz it's a NI.
- If filing in more than one jurisdiction, you have 2 choices:
 - File separately in each jurisdiction (each jurisdiction will review it)
 - File under passport system. Multilateral Instrument MI 11-102 and National Policy 202
 - One jurisdiction is selected as principal regulator, typically based on where your head office is located. You only deal with principal regulator even though you select other jurisdictions.
 - Thus, only the principal gives you a receipt and this receipt is issued on behalf of every other jurisdiction that you filed in. Principal binds all other SC. This applies to comment letters too.
 - No jurisdiction has the right to opt out of the system, exception ON. This is a multilateral instrument, ON is the one prov who is not adopted and can opt out and opt back in. If opted out, have to deal with them separately and get a separate receipt from them.
- Why file in more than one jurisdiction
 - Needs to be filed in every jurisdiction where you intend to sell securities.
 - Or needs to be filed in every jurisdiction where you are already a reporting issuer.

Time Frames in Prospectus Filing--NI 41-101

- s.2.3(2): prelim prospectus must be filed within 3 business days of when it is dated and signed (can't file a stale doc). Dated Monday, must be filed by Thursday.
- Final prospectus must be filed within 90 days from receipt date for prelim regardless of all the back and forth between you and SC.
- **2 kinds of offerings you can make under a Prospectus:**
 - **Underwritten Deal aka Bought Deal**
 - An underwritten deal must be completed within 42 days (s.11(3)) of the date of receipt for the final prospectus.
 - the broker makes a firm commitment to purchase a set number of shares. Offering is pre-sold, or 'bought.' Broker has made a firm commitment to buy shares. Ex – broker says he is going to sell \$1 mill shares. If he doesn't sell that many then he must pick up the rest.
 - **Market Out Clauses** – Notwithstanding commitment to deal, broker will have escape clauses (decline in market prices, financial position of issuer deteriorates, stock market crashes, adverse material change in co's affairs, etc); if any of these happen broker is freed of his commitment.
 - **Best Efforts Offering**
 - Offering must cease within 90 days of the date of receipt for the final prospectus. If you file an amendment, you can 90 days from the date of your amendment. But in no circumstances can you get more than 180 days from the date of the original prospectus receipt.
 - No firm commitment; rather the broker acts as agent – just agrees to try their hardest (best efforts) to sell as many securities as possible. Price is agreed upon in advance and the broker passes on the proceeds to the issuer after taking commission.
 - Comes with a minimum and maximum offering. If the minimum is not met within the initial 90 days, then the prospectus dies and the subscriptions must be returned to the subscribers. Prospectus will set out a minimum number of shares that have to be sold or the deal will not close. Prospectus also sets out a maximum amount that broker can sell (ex. can't sell more than 2 million shares).
- **Underwriter = the broker who is doing the financing for you.** Doesn't matter if it is an underwritten deal or best efforts deal, the broker is an "underwriter" for both types of offerings.
- Pursuant to s.110 of SA, in order to *distribute* securities I must file a prospectus and get receipt. Once I get a receipt I become a reporting issuer for those specific securities mentioned in the prospectus. Once I distribute all those and if I want to distribute new shares then corp must file a new prospectus. Just cuz I am reporting issuer doesn't mean I can bypass the prospectus requirements. You can only distribute securities thru a prospectus.
- **Initial Public Offering (IPO):** first time a corp goes public.

- **Continuous distribution:**
 - Mutual fund can sell units for a whole year. The 42 day and 90 day limits do not apply.
 - Therefore prospectus is good until it lapses, which is 12 months after the date of the prospectus. If 30 days before lapse I file a pro-forma prospectus (renewal) and then file prospectus within 10 days after lapse date I can continue selling.
- **Amendment to prospectus**
 - **Required to file this if there has been a material change that occurs to the company**
 - 2 relevant time frames wrt Amendments (part 6 of 41-101):
 - **After you file prelim and before it goes final (in the vetting stage)—s.114**
 - **If an adverse (negative) material change occurs company is required to file an amendment to the prelim prospectus.** Must file it within 10 days of the material change.
 - Material change: reasonably expected to have a significant impact on the value of our securities.
 - **After I file final prospectus and before the offering closes—s.115**
 - If a material change occurs, positive or negative, I must file an amendment to my final prospectus within 10 days.
 - So before final is filed, only have to file adverse material changes. After, must file for any type of material change, good or bad.
- The faster you close the better cuz there is less chance of a material change occurring and you don't have to file an amendment.

(C)—Disclosure vs. Merits

- **Role of SC is to ensure that investors are provided with enough info to make a fully informed decision about investing in the company = “adequacy of disclosure”.** SC is NOT concerned with the merits of the investment (good or bad investment) except in the following situations:
 - s.120(1): SC will refuse to issue a receipt where it considers that it is NOT in the public interest to do so. This discretion power is based on 120(2).
 - 120(2): **The Executive Director shall not issue a receipt for a prospectus under this Part if the Executive Director considers that.** If SC is going to refuse a receipt they must do so based on one of the grounds found in 120(2)—and these grounds are mainly about the merits of the investment.

Section 120(2)

- the prospectus or any document required to be filed with it
 - fails to comply in any substantial respect with any of the requirements of this Part or the regulations,
 - contains any statement, promise, estimate or forecast that is misleading, false or deceptive, **or**
 - contains a misrepresentation.
 - If there is a defect with the prospectus then SC can refuse to issue receipt
- an **unconscionable consideration** has been paid or given or is **intended** to be paid or given for promotional purposes or for the acquisition of property.
 - Company has negotiated to buy property, they need 10 million to buy it but the property is only worth 10K, but company is going to pay 10 million for it. This is an unconscionable consideration for this property.
- The aggregate of proceeds from the sale of the securities under the prospectus that are to be paid into the treasury of the issuer, and the other resources of the issuer, **are insufficient** to accomplish the purpose of the issue stated in the prospectus.
 - Company has no money or other resources, purpose of prospectus is to build an assembly plant, this plant will cost 10 million to build and I am raising 5 million. I'll take your money but I won't achieve my objective.
- the issuer **cannot reasonably be expected to be financially responsible** in the conduct of its business **because** of the financial condition of the issuer or any of its officers, directors, promoters or control persons.
 - Company is in terrible financial shape, directors have history of bankruptcies, SC will say we are not going to let you blow any more people's money--you are not responsible.
- the business of the issuer may not be conducted with **integrity** and in the **best interests** of its security holders **because** of the past conduct of the issuer or any of its officers, directors, promoters or control persons.

- This goes beyond financial responsibility. If president has record for being convicted of fraud, then he does not have integrity.
- (f) a person or company that has **prepared or certified any part of the prospectus**, or is named as having prepared or certified a report or valuation used in or in connection with a prospectus is not acceptable.
 - The accountant is not acceptable or engineer or appraiser. They have a history of getting sued for filing crappy financial statements or not a member of CPAB.
- (g) an **escrow or pooling agreement** that the Executive Director considers necessary or advisable with respect to securities has not been entered into.
 - **What is Escrow?** Placing the shares of management and its principal security holders in trust following the issuer's offering, which are then held by an escrow agent, who only releases the shares as according to the terms of the escrow agreement.
 - **What is the purpose of escrow?** An escrow agreement ties the issuer's management and its principal security holders to the issuer by restricting their ability to sell their securities for a period of time following the issuer's offering. This gives them an incentive to devote their time and attention to the issuer's business while they are security holders
 - If the right people (directors) have not entered into an escrow agreement then SC can refuse to issue a receipt.
- (h) Adequate arrangements have not been made for the holding in trust of the proceeds payable to the issuer from the sale of the securities pending the distribution of the securities.
 - If broker sells securities, investors give him chqs, after all the investors are in he cuts a chq to the company. However, if company is collecting money from the investors, how do we know you are actually going to issue those shares, we want that money to be held in trust so you don't take money and then not issue shares.

ASC v. Alberta Resource Capital Corporation

- Director of SC raised concerns under s. 120. Director chose to refer the matter to a panel. SC has an administrative function and a judicial function. The judicial function holds hearings or panels. The administrative function or the staff issue or refuses to issue receipts.
- **FACTS** - AB Resource Capital wanted to raise a small amount of money (\$50,000) by selling shares at 5cents. Company had been newly incorporated. The directors put in \$50,000 of their own money at exactly the same price. Objective of the company was to identify oil and gas properties they might want to buy. Once identified at that time the company will be a public company and can use liquidity in its stock to finance those acquisitions or do a share deal but that requires that it be a public company. It is clear that if company identified a property it wanted to buy it would not have enough money to finance acquisition w/o doing a share deal. Director had some concerns as to whether it was appropriate for the SC to issue a receipt – Director was concerned that the co was only raising enough money to identify acquisitions, and not enough funds to complete any actual acquisitions.
- Question 1: does corp lack of any development history mean it cannot give investor enough info to make a proper decision?
 - No. You cannot use fact that a company is new to refuse to issue a receipt – you have to rely on one of the public interest concerns set out in s.120 of the Act. **This case is authority for the proposition that you must fall within one of the enumerated items to refuse to issue a receipt—120 is not an open ended discretion.**
 - Key question: does prospectus contain full key disclosure? Newly incorporated does not necessarily mean that there is not enough info for investor to make proper decision.
- Question 2: **The use of a prospectus offering by a shell company for the primary purpose of obtaining a listing on the AB Stock Exchange is NOT a legitimate use of the Securities Market.**
 - A shell company is a company that is inactive and does not have a business purpose, or one whose business purpose has been exhausted or abandoned.
 - However, in this case the company deleted its primary intention of being listed on the AB Stock Exchange and has a valid secondary intention of “identifying oil and gas participations” which is a legitimate use of the securities market. Listing on the exchange is a means to an end.
 - Purpose of AB Resource: identify potential acquisitions, not acquiring them.

- Question 3: is it in the public interest for any first time issuers to ask for money without then having the ability to acquire what they have identified? Give us money to identify but we won't have enough money to actually buy them.
 - SC says this is okay, this happens all the time. Ex. Mining operations.
 - It does not matter if company does not have adequate financial resources to explore properties once identified.
- Question 4: are the company's resources sufficient to accomplish its stated purposes?
 - Panel did not answer this question, left it up for director to decide. Gave him some direction to answer this question:
 - 1st: what is the purpose? Is it just to identify potential acquisitions or to buy these newly identified
 - 2nd: resources does not just mean money. Management itself can be the key resource, are there people on the board who have oil and gas experience. Here they had no money, so the management becomes the key focus.
- Question 5: is it in the public interest for the public to be asked to invest when promoters of offering have nothing to mitigate risk of offering
 - The promoters do not have an obligation to reduce the risks associated with the offering unless risks are of the kind that come within the definition of s.120 of the Act. The higher the degree of risk to the investor, the higher the disclosure should be in the prospectus. Commission has no basis assessing merits of investment except to the extent that s.120 authorizes refusal to issue a receipt. Beyond that the only job of the SC is to determine if disclosure is adequate. Question of whether or not investor should invest is for the investor alone to decide (question of merit)
- Next 3 questions: there is prospectus with very little info, now company is going to subsequently try to raise future money (there may not be another prospectus--just continuous disclosure). Implied in this question: 2 things (1) we don't think rules for continuous disclosure is strong enough (2) we don't think the company will follow it.
 - SC: don't assume the rules are adequate and don't assume that company is going to break the rules
- Question 9: is it in the public interest for director to escrow all the securities of its directors/promoters?
 - At the time, SC had rule that said that we will only escrow director shares to extent that there is dilution to investors, dilution requires disclosure in prospectuses. In 1986 escrow policy was different than today. Today all of your stock has to go in escrow and is gradually released. In 1986 how much stock that would go into escrow would be determined based on dilution to investors. In this case no escrow of shares of directors and promoters was necessary b/c promoters and directors paid the same price for shares of the company as the public. Promoters and directors did not purchase "cheap shares" or receive "founder shares" at a lower price than the public (as is commonly the case with most junior issuers).
 - **DILUTION** – At the time of ARC, the exchange required that the amount of shares to be escrowed would be based on the percentage of dilution experienced by the investors.
 - In context of prospectus, dilution means economic dilution to an investor who is buying a share of certain value. Ex – President of Co. issues to himself 1 mill shares for \$0.01 (penny) for a total of \$100. Wants company to go public to raise \$1mill and wants to sell another million shares for \$1.00 each. This means that the book value is \$1,000,000 but because there are 2,000,000 shares outstanding the book value is \$0.50 per share. This means that investor just paid \$1.00 for the share but it is already only worth \$0.50. In this case the investor has suffered 50% dilution to his investment. In 1986 escrow policy was that we are going to take that percentage dilution and lock up that percent of the company's stock in escrow. If the dilution was only worth 20% we would only want 20% of shares in escrow. In this case the Directors paid \$0.05 a share and were offering the shares to the public at the same price so there was no dilution; therefore did not need to escrow any of the shares.
- Question 10: we need enhanced disclosure of directors cuz they are the key resource
 - In this case it would be in the public interest to include the resumes/records of the directors and promoters in the prospectus b/c the investor will be required to rely directly on the skill, talent, and ability of the directors and promoters to conduct the business purpose of the company. In this case the investors

are investing in management so there needs to be heightened disclosure about management so investors can make an informed decision.

- **4 principles to take from this case**

- 1. Disclosure vs. Merits – it is not the job / purpose of the ASC to address the merits of an investment (except within the narrow authority provided in 120(2)), but rather, to make sure an investor can make a fully informed decision as a result of the C making full, plain and true disclosure
- 2. Public Interest Discretion – the ASC can only exercise their discretion to refuse a receipt for a prospectus when they rely on a ground enumerated in 120(2)—this is not an open-ended discretion.
- 3. Follow own Policies – the ASC must follow its own policies where it has made them; if a company has done everything it is required to do, then the ASC should not refuse to issue a receipt
- 4. Creation of the CPC Financing – a special prospectus filing; formerly, these companies were termed Junior Capital Pool Companies, or Nickel Pool Companies; the program is now almost 20 years old and is a major source of financing on the TSX.V (almost half of all filings are CPC's). AB Resource was the first company to do this.

CH 2: PROSPECTUS FORMAT and REQUIREMENTS; LIABILITY; DUE DILIGENCE

(A)—Prospectus Requirements

Form 41-101F1--Information Required in a Prospectus

- Item 1 - Cover Page Disclosure
 - Front page of a prospectus is the cover page or face page (this is not a summary).
 - 91.2: red herring for prelim must be on cover page
 - Name of the company, number and type of securities, pricing, distribution table (detailing min and max offerings), net proceeds, disclosure where the shares will trade, summary of risk factors, brief description of underwriting agreement
- Item 2 -Table of Contents
- Item 3 - Summary of Prospectus
 - Brief one or two para of major sections of the prospectus.
- Item 4 - Corporate Structure
 - What kind of entity is it (AB or BC corp), where is it incorporated, what is the corporate structure (subsidiaries, parent, etc.). Not talking about the business, talking about the corp in legal terms
- Item 5 - Describe the Business
 - What does business do, history of the business
- Item 6 - Use of Proceeds
 - How are we going to spend the money we will raise (business plan) and also what resources they have at present. How much net proceeds we estimate to raise. How much fees it will cost to raise this money.
 - Allocate dollar amounts for how much each part of your plan will cost (200k on marketing).
- Item 7 - Dividends or Distributions
 - Does the company pay dividends, what is the history of it paying dividends
- Item 8 - Management's Discussion and Analysis (MD&A)
 - Management's discussion of its financial statements (results and conditions). Explains what these financial statements mean. Ex. Had revenue of 10mil and profit of 1.2mil and then next year revenue was 11 mil and profit 1.3mil-->it will explain why those numbers changed from year to year.
- Item 9 - Earnings Coverage Ratios
 - If you have a security that is paying set return (ex.4% dividend rate), this ratio is an analysis of where this dividend comes from (ex. take 10% of profits to pay for all these dividends)
- Item 10 - Description of the securities Distributed
 - What is we are actually selling. Ex. common shares, warrants, options, preferred shares, etc. what kind of rights do you get with the common share.
 - Ex. Special warrants prospectus: warrant is a kind of option (right to buy a share at a set price within a certain amount of time). A special warrant is a right to receive a security or share for no additional consideration because you have already paid the price for it. Pay company a buck for piece of paper

(special warrant), this person can then cash in when they want. Why do this instead of selling a share? Prospectus is a long process, a special warrant is an exemption from the prospectus (when I get a receipt for my prospectus which qualifies then you can trade that piece of paper)

- Item 11 - Consolidated Capitalization
 - Chart that has my share path in a simple format. Shares outstanding now, shares outstanding after offering, total. --> shows share capital of company
- Item 12 - Options to Purchase Securities
 - What other options are out there (how many, their terms and prices)? Does President have an option to buy at 10 cents while everyone else has to buy the share at \$1.00
- Item 13 - Prior Sales
 - Prior sales of the class of securities that I am offering. I am offering to sell at a \$1 a share, over the past 12 months, how many shares have I sold and at what price.
- Item 14 - Escrowed Securities and Securities Subject to Contractual Restriction on Transfer (**see below**)
 - SC has a policy that requires shares owned by principals of the company be deposited to a trust acct (held by a trustee). This section discloses the escrow agreement, how many shares are going to escrow, for how long, terms of release. The less shares out there the better for the share price.
- Item 15 - Principal Security holders and Selling Security holders
 - **Principal = those who own 10% or more of the outstanding shares of the company. Must disclose everyone who has a 10% share position**
 - **Selling security holder:** shareholders who are selling their shares thru the prospectus. In most cases, a corp will file a prospectus to sell shares from its treasury--investors put their money into the corp (the corp gets that money). Sometimes a s/h wants to sell their shares, might have to file a prospectus to do that. Why? A control person is someone who owns more than 20% of the shares, when a control person wants to trade their shares, that is a distribution, and where a trade is a distribution it requires the filing of a prospectus. The investors money goes to the controlling person in this case. Ex. Govt owns a crown corp and is privatizing it (govt is taking their shares and selling them).
 - We want disclosure of the selling security holder
 - Primary distribution = shares sold from treasury. Secondary distribution: shares from securityholder
- Item 16 - Directors and Executive Officers
 - Who is in charge of running the company--who they are, what is their background, what have they been doing for the past 5 years, disclosure about bankruptcies and penalties and sanctions those people have been subject to.
- Item 17 - Executive Compensation
 - Disclosure about salary and bonuses paid to senior officers
- Item 18 - Indebtedness of Directors and Executive Officers
 - Do any of these people owe money to the company?
- Item 19 - Audit Committees and Corporate Governance
 - Continuous disclosure requirement: every pubco is required to have an audit committee to disclose their corporate governance.
- Item 20 - Plan of Distribution
 - Describes how corp is going to distribute the securities→agreement between company and underwriter. How many shares and at what price, compensation to underwriter, is it an underwritten offering or best efforts, min/max, last date it will be open
- Item 21 - Risk Factors
 - Required to disclose material risks particular to the company, the security and the industry (ie. Oil and gas industry in general) wrt the investment. This does not include general risks about investing (if the company).
- Item 22 - Promoters
 - Promoter is the founder, or substantially reorganized the affairs of the reporting issuer.
 - Who is this person and what compensation have they received or are going to receive.
- Item 23 - Legal Proceedings and Regulatory Actions

- Material law suits or regulatory proceedings the company is involved with
- Item 24 - Interests of Management and Others in Material Transactions
 - Conflicts of interest disclosure → any material transactions between issuer and director over the past 3 years.
 - Ex. Is the company renting its building from a company owned by the president's wife?
- Item 25 - Relationship Between Issuer (or Selling Security holder) and Underwriter
 - Relationship between issuer and underwriter: is there a relationship between these two guys (CIBC is underwriter, company has LOC with CIBC, CIBC has a conflict of interest to raise as much money as possible as underwriter to pay off their loan)
- Item 26 - Auditors, Transfer Agents and Registrars
 - Registrar: compiles registry of the s/h list--who are these people
 - Transfer agent: performs the transfers of shares
 - Auditor: audits financial statements.
- Auditors are an accounting firm that is retained to conduct audit of company's financial statements.
- Transfer agents and registrars are usually the same people.
 - When company sells shares, they must issue a share certificate; this is an onerous task for large public companies so they will usually appoint a trust company to act as transfer agent
 - The transfer agent then performs the role of issuing new shares out of treasury (with consent of C) and effecting the transfer of shares between SH's (no need for consent)
- Item 27 - Material Contracts
 - Listing of all agreements that are material to the company and its business over the past 2 years. Ex. underwriting agreement
- Item 28 - Experts
 - People who we have retained for expert advice given to corp who prepared a report or opinion referred to in the prospectus. Ex. Auditors (audit opinion appears in prospectus), engineer report on oil and gas property, legal opinion.
 - Discloses any interests these experts have in the company (conflict of interest--lawyer owns a lot of shares in company)--auditor can't own shares in a company they audit
- Item 29 - Other Material Facts
 - Anything we haven't listed yet that you might want to know--catch all category
- Item 30 - Rights of Withdrawal and Rescission
 - Disclosure about what investors rights are to the sue company if there is a misrep in the prospectus.
- Item 31 - List of Exemptions from Instrument
 - Did company had to get any special waivers from SC cuz they couldn't fit exactly within the rules.
- Item 32 - Financial Statement Disclosure for Issuers (**see below**)
- Item 33 - Credit Supporter Disclosure, Including Financial Statements
 - A company may have support from somebody. Ex. Company is offering debt securities and its parent company is guaranteeing payment of those securities. Part of our investment is our reliance on guarantor, so we need some info about guarantor.
- Item 34 - Exemptions for Certain Issues of Guaranteed Securities
- Item 35 – Significant Acquisitions (**see below**)
 - If you have made a significant acquisition or are planning to--must provide financial statements about it.
- Item 36 - Probable Reverse Takeovers
 - Similar to a sig acquisition. If likely to enter into a reverse take over transaction--disclosure about that.
- Item 37 - Certificates
 - Certain people are required to sign the prospectus verifying that it contains full, plain and true disclosure.

More in depth look at some of these items

Financial Statement Disclosure--Item 32

- These statements have to be current. What determines current? Timing requirements are matched to what they are for existing public companies.
- **1st thing you do: figure out if company is a venture issuer or not?**

- **Venture Issuer = If your securities will NOT trade on the TSX or a US market place or market place outside of North America.** Not a venture issuer = If you trade on TSX, US, etc. If you trade on CNSX you are a venture issuer.
- **If you are a venture issuer, you must include financial statements for the last 3 years that ended more than 120 days ago** (if year-end ended more than 120 days ago it has to be disclosed).
 - Ex. Feb 1/10 prospectus is filed: year-end for corp was Dec 31 = 32 days ago, which is less than 120 days. Therefore, this corp would NOT put in their 2009 Financial Statements in the prospectus—Dec. 31 06, 07, and 08 would have to be disclosed. **Put another way, if a corp files their prospectus within 120 days of the year-end then they don't have to include it.**
- **If you are NOT a venture issuer (trade on TSX--senior company), you must include financial statements for the last 3 years that ended more than 90 days ago.** Shorter deadline to get financial statements done.
 - Ex. April 15 prospectus is filed: year-end for corp was Dec 31,09 = 105 days, which is more than 90 days so corp would include 09, 08, and 07 financial statements.
- **Year end statements must be audited (all 3 years)-->audit report. These must be included in final prospectus (not prelim)**
- **Must include additional Interim Financial Statements--am I a venture issuer or not?**
 - If a corp is a venture issuer, it must include most recent quarterly statement that ended more than 60 days ago. If year end is Dec 31, quarters are March 31 June 30 and September 30
 - If corp is NOT a venture issuer, it must include most recent quarter that ended more than 45 days ago.
 - Ex. Feb 1 filing prospectus: corp is less than 90 days after its year end. When is the last quarter that corp had more than 60 days ago—Sep 30/09 (with a set of comparative numbers to Sep 30/08→include this, but not Dec 31/09.
 - June 15 issuing prospectus: the last year end was dec 31/09, first quarter is mar 31--is this more than 60 days ago--if yes then you include mar interim statement.
 - Interim statements do NOT have to be audited. But they must be reviewed by the accountants--Reviewed with a comfort letter (negative assurance letter) for these quarterly financial statements.

Significant Acquisitions--item 35

- **In past year did corp make any significant acquisitions or is proposing to make one soon, then required to provide separate financial statements for that acquisition (ie. The target company).** Ex. If we are buying assets or shares or business, must provide financial statements.
- These statements have to be **audited**.
- Include a **pro forma** financial statement-->takes financial statements from main company and target company and adds the numbers together...if we owned company from beginning of year here is what our numbers would like if we had owned from beginning of year.
- **What is a significant acquisition: 2 Parts to Significant Acquisition TEST:**
 - First
 - If senior company, 20% is threshold
 - If venture issuer, 40% is threshold
 - 2nd: What are we measuring: assets, income or investment
 - If target companies assets are bigger than 20% of our assets it is sig (I'm worth 1 mil and target is worth 200k then this is sig). If venture issuer that number becomes 40%. **Compare assets to assets.**
 - How much income or revenue did target make compared to us. **Compare income to income.**
 - Investment: how much we invest in that target--includes what we pay for it as well as other money inject into it. Pay 200k for it and then inject 100k in it that is 300k investment. Is this 300k investment greater than 20% of our total assets. **Compare investments to assets.**

Disclosure of Escrow Securities—Item 14--National Policy 46-201

- Policy says that every single share that is owned by a principal must be deposited in escrow.
- Who is a principal:
 - Anyone who has been a promoter of the company over the past 2 years before the prospectus

- Every Director or senior officer of the company
- Someone that owns more than 20% of the outstanding voting rights (this is a control person)
- Person that owns more than 10% of outstanding voting rights **and** either has the right or has appointed at least one director or officer.
- Any company or partnership that is more than 50% controlled by a principal
- A principal's spouse (whether or not she lives with me) and any other relative that lives at the same address as me
- When we calculate percentages to determine if someone is a principal, we do it on a diluted basis:
 - Take into account the shares we are offering. Selling a million shares, assume they are already sold.
 - And assumes all options will have been exercised .
- Escrow: someone is appointed as trustee to hold those shares with us. While in escrow, cannot sell them without getting approval of SC (exceptions: transfer to another director or RRSP account).
 - While in escrow, maintain voting right. If there is a cash dividend paid out on shares I get that cash. If dividend is paid out in stock those shares go into escrow along with all the others
- **When does principal get shares out of escrow—depends on if the corp is an established issuer or emerging issuer:**
 - **Established Issuer = (i) corp is listed on TSX or (ii) listed on the Venture Exchange and is recognized as being a Tier 1 company.** If I meet (i) or (ii) I am an established issuer. As soon as my offering is closed (listing date) 25% of the shares are released to me immediately. After 6 months another 25%, then after another 6 months another 25%, and then after another 6 months the last 25%. So in total it takes 18 months after the listing date.
 - **Exempt companies** = TSX exempt company or have more than \$100 million in shares being traded, then you are exempt from these escrow requirements and principals don't have to deposit their shares.
 - **Emerging Issuer:** on the listing date 15% are released; after that every 6 months another 15% is released, so that in 36 months (3 years) all the securities of the principals will be returned.
- Why escrow? Provides incentive to principals to devote their time and attention to company for a reasonable period of time. Want to see principals committed to stay with company for a reasonable period of time.

(B)—Liability and Due Diligence

Purpose of prospectus: disclosure of relevant facts that will allow investors to make an informed investment decision. This disclosure must also be accurate. **Accurate = every prospectus must contain a certificate signed by a number of people which confirms that the prospectus contains full, plain and true disclosure of all material facts.**

Closer look at purpose and accurate:

1. **Criteria for disclosure is materiality**--if something is material it must be disclosed; if it's not material don't disclose it.
 - **What is a material fact: a fact that would reasonably be expected to have a significant effect on the market price or value of the security.**
 - This is context driven: size of company has impact on materiality (a \$1 million K is not material to a \$3 billion company).
2. **Disclosure must be full -- full = complete.**
 - Must not fail to disclose something that is material.
 - This includes a fact that is required for a statement to not be misleading in the circumstances in which it is made ... A half truth is not a truth. You can say something is a fact but if you don't tell the rest of the story it might be misleading. Ex. K to sell widgets, but it will only come into effect if Liberals win. By not telling Liberal part the statement could be misleading.
3. Disclosure must be true
4. Disclosure must be plain = understandable to a layperson (provide glossary of technical terms).

Signing the Certificate—s.116

- **Who must sign this certificate (certify that it is full, plain true disclosure)**

- CEO (chief executive officer)
- CFO (chief financial officer)
- It must also be signed by another 2 directors other than CEO and CFO
- It must be signed by any promoter or guarantor of the company
- If issuer is not a corp, (like a partnerships, or mutual fund), then you may not have a board of directors, it is to be signed by the persons who fulfill those functions.
- Also, SC has authority to require anyone that it wants to sign the certificate. Ex. Someone owns 80% of the shares.
- s.117(1): Underwriter (broker) must also sign a certificate, but his certificate just says to the best of my knowledge, information and belief this prospectus contains full true plain disclosure.

Civil Liability

- **Consequences of certificate being not true = prospectus contains a misrepresentation:**
 - **What is a misrep** = a fact that is not true or failing to disclose a fact that should have been disclosed.
 - There are CL remedies for misreps (tort of negligent misstatement, fraud, etc.). All of these CL remedies have a problem: Negligent misstatements, fraud are difficult for a PL to establish so the Act provides some statutory rights/remedies to help a PL deal with misrepresentations which alleviate many of the proof problems.
- Which is why everyone uses Securities Act s.203--statutory civil rights of action. **There are 2 types of rights of actions in s.203:**
 - **Right to Damages** (sue for money lost due to a misrep--I paid a \$1 a share, but they are only worth 75 cents due to your misrep, i keep shares and sue for damages);
 - **Right of Rescission** (undoing the transaction--give shares back and money back)
- Can't sue for both. What you sue for effects who you can sue
- If you sue for damages you can sue (**who is subject to liability for damages**):
 - the issuer (the company) or selling security holder
 - Every underwriter that signed prospectus
 - Every director of the issuer
 - Anyone whose consent was filed wrt the prospectus, but only wrt their reports/opinions/statements. Example the auditor whose financial statements are included is required to file consent wrt use of the statements; his liability is limited to those statements.
 - And every other person who signed the prospectus (ex. promoter)
- If you sue for rescission, you can sue (**who is liable for rescission**):
 - Issuer or selling security holder
 - Each underwriter that signed the prospectus
 - And every other underwriter of the prospectus that sold shares from this prospectus

Proof of Claims

Under the *Securities Act*, **purchasers are deemed to have relied on any misrepresentation – misrepresentation does not have to be proved/demonstrated** (doesn't even matter if s/h has never read the prospectus)

To succeed in making a claim for misrepresentation purchaser need only prove that:

- (1) prospectus contained a misrepresentation
- (2) they purchased securities offered by that prospectus (does not mean they had to buy them thru the prospectus; rather A may have purchased thru prospectus, but A sold them to B), and
- (3) they bought securities during the period of distribution (date of receipt to closing of offering).

****If these 3 facts are proved burden of proof will shift to DFs to try and establish a defence.****

- Scenario: company is doing a IPO, only place I can buy shares is thru prospectus. But purchasers do not have to have bought shares through prospectus – they just have to have bought them **while the prospectus was being offered**. If company is public and stock is trading on exchange and existing public company files a prospectus – from the time prospectus is filed until the deal closes we are in the period of distribution and anyone who bought shares during that period of time is a potential PL.
- **Limits on this Liability**

- **S.203(3)** – purchaser can sue under damages or rescission, but not both.
- **S.203(8)** – underwriter is limited to how much he underwrote. X sold half the shares, liable only for that.
- **S.203(9)** – a claim for damages—only liable to loss that is attributable to the misrep. There is no liability for depreciation of value that is not caused by a misrepresentation [if only \$0.25 is attributable to misrepresentation and the rest is due to drop in market, I can only sue for damages for the amount caused by the misrepresentation - DF only liable to the extent of the misrepresentation]. If co can demonstrate that part of loss is attributable to other causes he can limit his liability.
- **S.203(13)** – the amount recoverable under this section shall not exceed the price at which the securities were offered to the public. Ex – If I sold shares at \$1/share, no one can sue me for damages for more than \$1/share. If i raised 10mil my liability is limited to 10mil.
- **If a misrep is proven, the D still has Defences available (if D can prove any one of these it won't be liable):**
 - However, a Company has only 1 defence it can raise: If company can prove Investor had knowledge of misrep--bought with knowledge of misrep. This is rebutting his deemed reliance.
 - **203(5) defences are available to everyone else except for company itself:**

- 203(5)(a): The prospectus was filed without the person's knowledge or consent **and** that, on becoming aware of its filing the person promptly gave reasonable notice that it was so filed.
 - Director is on a board, he was on holiday for month, they filed prospectus while he was gone, he didn't agree to that or have knowledge of that and on becoming aware of it he let SC know right away that he had no knowledge.
- 203(5)(b): **After** the issue of a receipt for the prospectus and **before** the purchase of the securities by the purchaser, on becoming aware of any misrepresentation in the prospectus the person **withdrew** their consent to it **and** gave reasonable notice of the withdrawal **and** the reason for it.
 - Director gives notice after receipt but before purchaser bought the shares.
- 203(5)(c): With respect to any part of the prospectus purporting to be made on the authority of an **expert** or purporting to be a copy of or an extract from a report, opinion or statement of an expert, the **person had no reasonable grounds to believe and did not believe that**
 - (i) there had been a misrepresentation
 - (ii) the part of the prospectus did not fairly represent the report, opinion or statement of the expert, **or**
 - (iii) The part of the prospectus was not a fair copy of or extract from the report, opinion, or statement of the expert.
 - Must have reasonable grounds to believe and actually believe there were no misreps in the expert report. Or report is correct but when summarized in prospectus a mistake had been made.
- 203(5)(d): With respect to any part of the prospectus purporting to be made on the person's own authority as an expert or purporting to be a copy of or an extract from the person's own report, opinion or statement as an expert, **but that contains a misrepresentation attributable to a failure to represent fairly the person's report, opinion or statement as an expert,**
 - (i) The person had, after reasonable investigation, reasonable grounds to believe and did believe that the part of the prospectus did fairly represent person's report, opinion or statement, **or**
 - (ii) On becoming aware that the part of the prospectus did not fairly represent person's report, opinion or statement as an expert, the person promptly advised the Executive Director and gave reasonable note that misuse had been made of it and the person would not be responsible for that part of the prospectus.
 - If there is a mistake in an experts report then he is liable.
 - But if expert's report is correct but prospectus made mistake in reporting it then expert has a defence if expert has reasonable grounds to believe that prospectus fairly represented his report or becoming aware of the misrep i promptly advised SC.
 - As an expert, and it is quoted in a prospectus, you are required to give your consent, which states that I read prospectus and have no reason to believe that the prospectus makes no misrep wrt my report. This defence is a direct contradiction to what my consent letter states--tough defence to prove (you could prove it if prospectus i read was different version than what was filed).

- 203(5)(e): With respect to a false statement purporting to be a statement made by an official person or contained in what purports to be a copy of or extract from a public document,
 - (i) It was a correct and fair representation of the statement or copy of or extract from the document, **and**
 - (ii) The person had reasonable grounds to believe and did believe that the statement was true.
- Statement: we were incorporated on dec1 under ABCA, this is what certificate said, and corp relied upon this certificate, and it turns out incorporation date is wrong then corp has got a defence.
- **s.203(6)-Due Diligence Defence = the person conducted an investigation sufficient to provide reasonable grounds for a belief that there had been no misrepresentation, and believed that there had been no misrepresentation.**
 - Ensuring proper due diligence protects client interests and my own interests--lawyer will have written the whole prospectus based on info given from corp. If company gets sued based on misrep, I will be on list of people company will sue or add as a 3rd party.
 - Primary purpose of due diligence is to eliminate all misreps in the first place.

(C)--Defences – Due Diligence Defence

- Want to have done enough investigation to reasonably satisfy ourselves that contents of prospectus were accurate (full, plain and true)
- Due diligence defence will be made out if the person conducted an investigation sufficient to provide reasonable grounds for a belief that there had been no misrepresentation, and believed that there had been no misrepresentation.

What is due diligence? What constitutes due diligence will depend on 2 factors:

- (i) the fact scenario; and
- (ii) the person involved
 - Ex – outside director will not have as extensive knowledge about the co and therefore is not required to do as thorough an examination as the CEO but if you have particular expertise/experience in an area you may be expected to assume more responsibility in that area.
 - President, Chairman of Board may be held to high standard to ensure accuracy of Prospectus than outside director.
 - No diligence is not due diligence – wilful blindness does not get you off

What is due diligence?

- Looking at the minute book
- Reviewing of contracts, corporate records, and financial info
- Complying with the contracts – does reality match what the documents say?
- Other documents, deeds, certificates, registrations, financial information
- Sales budgets
- Interviewing management of the company

Due diligence examples—things you should do

- Meetings with the issuer's banker and major creditors concerning financing arrangements and any defaults;
- Contact with major customers or suppliers to determine any problems in their ongoing relationship with the issuer;
- Meetings with control block shareholders;
- Meetings with the auditors and the audit committee concerning the accounting system;
- Meetings with experts providing reports or opinions to be included in the prospectus;
- A review of the issuer's competitive position in the industry;
- A review of the financial statements to be included in the prospectus;
- A review of the backgrounds of directors and senior officers;
- A review of recent press releases, articles and reports concerning the issuer;
- A review of information circulars, annual reports, stock exchange filings, prospectuses, takeover circulars, etc.;
- A review of the articles of the incorporation of the issuer and significant subsidiaries of the issuer;
- A review of the minute book of the issuer and of important subsidiaries and amalgamating corporations;
- A review of certificates of status of the issuer and significant subsidiaries;
- A review of certificates of no bankruptcy of the issuer or its significant subsidiaries;
- A review of share ownership registers and share transfer registers;

- A review of corporate extra-provincial licenses;
- A review of other important licenses;
- A review of important leases;
- A review of material contracts including major supply agreements, labour contracts or collective agreements, executive management employment contracts, licensing and franchise agreements, debt instruments, loan agreements, major insurance policies, contracts or guarantees containing contingent liabilities, etc.;
- A review of writs, appearances, statements of claim or statement of defence;
- A review of evidence of remuneration paid to senior officers and copies of pension plans and profit sharing plans;
- A review of employee share purchase plans, executive share purchase plans, dividend reinvestment plans, etc.;
- Confirmation of indebtedness to directors and officers;
- Title examinations with respect to important properties and trade mark and patent registrations;
- Searches with respect to security interests.

As company's lawyer, must advise company

- However, individual's within company (Directors, Officers) will look to you
- As lawyer be aware that the company is your client but individual directors and officers will be looking to u to protect their butts as well as company butts. It is not unusual for lawyer to send directors of company a 'scare letter' that explains their potential liability if there is a misrepresentation in the prospectus. Explain their personal responsibility for ensuring accuracy

We have been discussing civil liability, BUT there are other areas of liability:

- **Penal sanctions, s. 134 (quasi crim):** Possible sanctions include fine of up to \$5mill or 5 years in jail or both. SC needs a finding of guilt.
 - It is more common for SC to proceed through administrative sanctions
- **Administrative Sanctions:** SC will issue notice of hearing and Commission panel will hold a hearing to determine whether or not you have violated the act.
 - **s.199** - they have the authority to impose an administrative penalty [fine] of up to \$1mill. They can also impose an order that you pay all of the portion of the costs of the investigation. To impose this penalty the act has to have been violated AND it must be in the public interest that the individual be penalized.
 - **Other Sanctions:** most common is a cease trade order; deny you use of exemptions, prohibit you from being a director or officer of any company. For imposition of other sanctions don't need violation of Act, only need to find it is in **public interest** to issue order

(D)--Overview of Process and Lawyer's Role

LAWYER'S TEAM

1. Client finds good Securities Lawyer (you)
 - a. Lawyer will manage the entire process
 - b. Lawyer gathers information from Company
2. Lawyer carries out filing process
 - a. File Prospectus on SEDAR
 - b. Communicate with SC during vetting process
 - c. Get approval to issue final Prospectus
 - d. Get receipt for Prospectus
3. As lawyer, you are responsible for finding good Accountant
 - a. Need to get audited financial statements
 - i. Only CAs can audit public companies , they must also be a member of Canadian Public Accountability Board
 - ii. Auditors are not supposed to do accounting work
 - iii. If they prepare statements they lose their independence - can't review own work
 - iv. Regular accountants should deal with accounting work
 - v. Hire separate auditors to complete audits
 - b. Get accountant involved early b/c takes time to get financial statements together and to conduct audits

- c. Timing depends on financial year end
- d. Accountant will give you business advice about structuring offering, money needed to carry out business plans, tax advice on structuring/re-organizing company

BROKER (Underwriter) TEAM

- These are the ppl who actually sell securities
- Without Broker, prospectus cannot get filed
- Must convince broker this is good investment for their clients (value proposition)
 - There must be an upside, value of company must go up once they have sold to their clients
 - Can't just sell at market value
 - Eg. No benefit if you buy at \$100 and no expectation the price will increase, but if you buy at \$90 this is good investment
- Broker will want to know if we raise this money for you, what will this do to your bottom line
 - This Permits brokers to project what value of company will be
 - Broker will advise on how many shares to issue and price per share.
- Broker will ask about "**President's List**"
 - If you want to raise \$5K, how many of your own friends will you bring into deal to make my job as broker easier?
 - They may become future clients for broker
 - Maybe this list will represent 10% of offering, maybe 50%
 - This may include Board, VP, friends, etc.
 - Broker still gets paid commission on this money even though lawyer raised it for him
- **Broker's commissions—Broker gets paid on 4 key elements:**
 - Lawyer expected to pay Broker's **out-of-pocket expenses** (they will have their own legal fees)
 - Lawyer expected to pay Broker's **due diligence** or **corporate finance fee** – likely \$25K-50K)
 - **Commission** - percentage of money raised through prospectus
 - Will vary depending on size of deal and company, risk, etc.
 - Typically 8-10%
 - **Options** – option to buy shares at \$0.50/share
 - Broker generally gets an option for 10% of shares offered by prospectus
 - Also known as Broker's warrant or B warrant
- Other things to negotiate with Broker:
 - **Type of deal** with Broker
 - Underwritten deal or bought deal (these are difficult to get)
 - Most IPOs will be best-efforts offerings
 - Broker might get **ROFR** for future financing deals
 - **Over-allotment** option (Green Shoe)
 - Option to increase size of offering
 - Over allotment option is different than broker option. Under broker option they have 12 months to buy shares at option price, they are buying them for their own account. Green shoe option says that if they have a maximum offering of ex 10 mill shares but if we get a lot of demand and we can oversell it we will reserve the right to increase the size of the offering by a certain percentage. If offering is increased it is usually no more than 10%.

Before doing all of above, must consider **organizational issues** within company:

- If private company, it will have private company restrictions in Articles
 - Maybe no public offerings, or limited number of SHs
 - May have to adjust these restrictions
- May have USA in place
 - This will need to be terminated
- Adopt suitable bylaws for a public co

- Consider share structure
 - Private company may have complex structure for tax purposes
 - This will need to be re-organized, simplified
 - Eliminate extra classes of shares, convert other classes into common shares
- Might have SHs loans in company
 - Eg. Financed for small amount of money
 - Get loans of books, re-pay them or increase amount of share capital
- Might have weird business structure for tax planning
 - Eg. Husband might own manufacturing business which leases property from another company owned by wife, equipment leased from family trust – this doesn't look good if company's go public
 - Will need to be restructured
- Messy paperwork/no paperwork
 - Did you ensure patent was transferred to company?
 - Assets put in company's name
 - No SHs meeting for past 10 years? Get these resolutions signed.
 - Are contracts in place?
 - Has lease expired? Have you done anything about this?
- Organizational tax planning arrangements should be made
 - Principals will have to put all stock into escrow when go public
 - Maybe get them into kids, spouse's name before going public
 - Tax Considerations – ex public companies do not have lifetime capital gains exemption – only available for private CCPCs. Take advantage of private co benefits while you still can (realize on this capital gains).
- Set-up Stock Option of Share Purchase Plan
- Review Management (does management team look good on paper)
 - People working within company (VPs, financial officers, Board)
 - Independence requirements for Board
 - Need people who qualify as financially literate
 - If listing on stock exchange, want someone (or more than 1) who has public company experience, can guide company through maze of public company requirements
 - People must be "clean" – must disclose bankruptcies, regulatory proceedings, must file PIFs with SC and Stock Exchange, criminal records checks, courthouse searches, unpaid parking tickets, other offences

Will be doing all of these things while getting Accountant involved. **Once mapped out**, find Broker. **Don't implement** until find Broker b/c Broker may say you need to change price or sell more shares. Once Brokers agree, **THEN implement**. Now we begin work on audits, preparing prospectus, etc:

- Organize share certificates
- Get CUSIP number, ISIN number (no one else will know you need this)
- Both numbers issued through Canadian depository – this is universal registration number
- Every public company has registration number
- Print prospectus somewhere
- If going to trade on exchange, make application to list on exchange
 - Must be done in conjunction with prospectus filing
- Need to be aware that stock exchange has requirements which will impact structuring decisions – examples:
 - min number of SHs
 - min net assets requirement
 - min share prices, etc.
- File the prospectus
- Broker will begin to sell: Once the broker has finished selling the shares, he will inform you that he is ready to close
- Select a transfer agent – the co will appoint someone to handle all the transfers, print the share certificates. Get ISN or QSIP number on top of them – anti fraud registration numbers (always look for this number).

CH 3: OTHER PROSPECTUS FORMS AND METHODS OF GOING PUBLIC

Up until now we have been looking at standard procedures for a long form prospectus, typically used for company's filing IPOs. There are other types of prospectuses that may be more efficient for a company to issue in unique circumstances.

(a) **Short Form Prospectus or Prompt Offering Prospectus (POP System) National Instrument 44-101**

- This does not apply for IPO. Can only be used for **existing public company**
- Permits **qualifying company** to issue a **short form prospectus**
- Allows qualifying issuer to file SF prospectus and go to market very quickly (much faster than long form prospectus)
- Shorter than long form prospectus (20 items instead of 40 items long)
- Includes information about offering itself, use of proceeds
- Can do this b/c relying on existing continuous disclosure
- BUT part of this short form prospectus says "we will **incorporate by reference** the following items from our continuous disclosure"
 - Financial statements on SEDAR
 - Material change reports on SEDAR
- Must still contain full, plain and true disclosure
- If you are incorporating doc by reference you are attaching same certification to doc, just as if you had cut and paste it into prospectus
- Therefore, if planning on filing SF prospectus, when preparing disclosure think am I prepared to certify this? Must take more care when preparing regular disclosure.

Qualifications for POP System – Eligibility Criteria to be a POP issuer?

- Issuer has to be an electronic filer on SEDAR
 - Public needs to have access to your info
- Must be a reporting issuer in at least one jurisdiction in Canada
 - Must be a track record of your continuous disclosure
- Must have complied with continuous disclosure requirement
 - Must have filed all required docs with SC
- Must have filed current financial statements and AIF (annual information form)
 - By current, we mean not in default of requirements
- Shares must be listed on recognized stock exchange
 - In CAN → TSX, TSX Venture, CNSX
 - Can avoid this if given acceptable rating by accepted rating agency (eg. Standard & Poor)
- Cannot have ceased to carry on business or only asset is cash
 - Must be active business (not a mere shell company)

To file SF Prospectus, must be in POP System

- Get in by electing to get in
- Do this by filing letter with SC, saying "we want to be in POP System"
- Must be filed at least 10 days before filing SF Prospectus
- So if SC wants to look at disclosure record they can before you file
- Only have to file election once, then you are always in system
- Can only get out by electing to get out, file letter saying "we don't want to be in system"
 - Costs you more to be in b/c SC reviews disclosure more often
 - Annual fees are more (in Alberta):
 - Not in POP - \$300/year
 - POP filer - \$1,300/year
 - Other provinces have similar pricing
- Can opt in and out at any time (as long as 10 days before)
- Advantages:

- Less information required in SF Prospectus
- Review time shorter
 - Under Passport, SC makes best efforts to provide initial comment within 10 days
 - Under POP, SC makes best efforts to issue within 3 business days

WHY does POP exist? (Key Elements)

- If you are existing public company, there is existing track record of disclosure
- If you have presence in marketplace, the market should be valuing your shares
 - Eg. Brand new company with 60 page prospectus, I have to decide on price
 - Eg. If company has history, trading at \$1.25 now, over past year went down, easier to make decision on price

(b) Capital Pool Corporation (Blind Pool)

- Venture Exchange Policy 2.4

RECALL: Alberta Resource Capital

- Co does not have an existing business/assets other than cash:
 - The purpose of a CPC is to raise a minimum amount of funds through a public offering, to then identify potential acquisitions, and acquire them through a reverse take-over (RTO).
- Since the co is initially just composed of cash, the investors essentially invest in the management
- This case opened floodgate for companies to do same thing. SC clamped down, led to policy 2.4 – CPCs
- Purpose of CPC is to raise a small amount of money, establish a publically traded vehicle, then look for things to buy. Also called blind pool bc investing blindly
- **Rules to satisfy to file a CPC:**
 - Principals must invest at least \$100K of own money and at least \$5K from each D and O
 - When you sell shares to public via prospectus the offering price has to be at least twice what insiders paid. **Share price to insiders must be at least 50% of the IPO price to the public.** Ex - If you want to sell shares to public at \$1/share to the public you as directors would have to buy shares at \$0.50 cents or more.
 - All shares of the insiders and their associates are deposited in escrow, to be released over 3 years after a “qualifying transaction” is completed
 - Release doesn’t start UNTIL we make an acquisition – different
 - Qualifying transaction must meet requirements of listing exchange
 - If the CPC does not complete qualifying transaction, the ASC will cancel the escrowed shares.
 - There are rules about minimum and maximum you can raise. Total seed capital prior to the IPO cannot exceed \$500K
 - Typically doesn’t exceed \$100K, which is min
 - Seed capital – it seeds the company before it goes public (also called sweat equity, because instead of getting paid they have cheap stock)
 - The IPO must be for at least \$200K and cannot exceed \$1.9M
 - The total capitalization, including both seed capital and public offering cannot exceed \$2M
- Therefore, minimum amount company has in it before expenses will be \$300K to \$2M
- Originally, standard model is to shoot for low side, NOW, tendency to raise larger amount of money
 - If raise min – keeping it tight as possible but not a lot to do things with
 - If raise – can do more with it, but given away greater % at cheap price

Critical Rule for CPCs: 70/30 Rule

- No more than 30% of the CPC’s cash (up to a max of \$210K) can be used on expenses other than identifying and evaluating potential acquisitions (must use 70% on identifying and evaluating)
 - So not giving money to blow on management salaries and legal fees

- Identify and evaluate
 - Due diligence
 - Accounting work
 - Engineer reports
 - Evaluations on targets
- Exceptions:
 - Up to \$25K can be provided as a non-refundable deposit on **arm`s length** transactions
 - Up to \$225K can be used as a refundable deposit or secured loan on arm`s length transactions
- Completing a qualifying transaction requires approval of the TSX Venture Exchange
- If it is a non-arm`s length transaction (related party) it requires **majority of the minority** SH approval
 - Eg. Set up CPC to buy own company – need SH approval
 - Call SH meeting, ask them to vote, you CANNOT vote, D and O cannot vote, anyone part of target company can`t vote, only true members of public can vote

Summary: CPC is fast-way to go public because Prospectus is standard form. Allows you to get public company quickly and cheaply. Problem is that you take 1 step process and turn it into 2 step process. Because once you create CPC you then need to complete qualifying transaction which requires exchange approval. Don`t avoid disclosure requirements. At end of day, same disclosure and audit requirements, but just broken this into 2 steps.

TSX may at times consider a SPAC (Special Purpose Acquisition Corporation)

- Used to be popular in States – not as much now because of Recession
- Essentially a CPC, no set rules govern
- Usually for significant amount of money
- Typical all money held in trust until they complete acquisition, then money released to pay for acquisition
- Fund set up to buy major businesses

Other Ways of Going Public besides filing a prospectus:

- Different ways of going public without distribution, *Securities Act*, s. 110(2) – can go public even without distribution
 - Can file prospectus for information purposes
 - Once we have received receipt for prospectus we have become reporting issuer even if we don`t raise money – **Non-Offering Prospectus**
 - Purpose is to get out of closed system

Clone Deal (Dividend in specie)

- Intro:
 - In order for a C to enlist on the SX, the C must have 300 SH`s (widely held) and the shares must be freely traded
 - However, an owner of a private company may have a lot of \$ invested and may not wish to give up any equity
 - Solution: use the clone deal → **an arrangement solely to meet the listing requirements of a SX where the C does not need to raise capital through an IPO**
 - Dividend in specie is way to carry out **Clone Deal** (effectively, clone a company)
 - Company wants to be public, but doesn`t need to raise money, just needs SHs to qualify for listing. So, private company files a Non-Offering Prospectus, they are now reporting issuer
- Procedure:
 - Have two C`s:
 - PubCo with public company status (could be active or shell) with many SH`s (1000`s);
 - PrivCo wishes to go public (have shareholders so it can trade on stock exchange) but does not wish to issue more shares to raise capital
 - PrivCo files a non-offering prospectus and becomes a reporting issuer (RI):
 - Once it is a RI, there is an exemption from the prospectus process under NI 45-106, s. 2.31 when dealing with dividend in specie (dividend in kind) (don`t need to file a prospectus)

- Involve the existing public company:
 - PrivCo issues shares to PubCo out of its treasury
 - Ex) PrivCo has 8M shares, PubCo may purchase 2M shares or take them for free [may be doing it a favour, or may think it's a good investment]
 - PubCo then declares a dividend, yet does not pay cash – rather, gives shares of PrivCo based on a % of shares that the SH's own in PubCo → a dividend in specie
 - PrivCo has now made a public distribution. The s/h have shares in PrivCo
- Result:
 - PubCo hasn't changed (except for maybe the money spent on shares) – has not gained / lost shares
 - All the SH's of PubCo are now also SH's of PrivCo
 - PrivCo is now owned, in part, by numerous public SH's
 - It now has over 300 SH's (so can trade on the SX) and is also a RI (outside of the closed system)
 - PrivCo has gone public without doing a public financing
 - ASC isn't reviewing a prospectus on behalf of the uniformed public, so will be easy when reviewing the prospectus issued solely for the purpose of becoming a RI
 - **Called a clone because PrivCo cloned a public SH base and the shares are held in the same framework / breakdown as in PubCo. pubCo stays exactly the same.**
- TSX Venture will not recognize clone distribution for their listing purposes, BUT CNSX will
- Therefore, may have to trade on CNSX for a while, then apply to move to another exchange

(c) Reverse Take-Over (RTO)

- When a CPC does its qualifying transaction it is very likely it will be a RTO
- Private company wants to go public, instead of filing prospectus can do RTO with existing public company
- Requirements:
 - Private company
 - Existing public company
 - Private company must be BIGGER than public company
- The RTO looks like a takeover, but works backwards – looks like PubCo takes over PrivCo, but essentially, PrivCo takes over PubCo
- Intro: PrivCo wants to go public, and a public shell C wants to acquire the PrivCo. The PubCo will acquire the PrivCo, yet will issue enough shares such that PrivCo will take control of the PubCo.
- The PubCo does not give cash to acquire PrivCo; rather it issues shares to PrivCo. Because private company bought is worth so much, PubCo had to issue a ton of shares, so many that now the old owner of PrivCo own more shares than the controlling group of PubCo do, so old private company owner is now the controlling SH of the new PubCo.
- So guy who owns private company does not own it anymore; instead he NOW owns 80% of public company, so still controls his business, but had to give away small piece for purpose of being public.
- SEE BEFORE SLIDE
 - Public company (worth \$200K) with 2 million shares issued (Board of Directors have 1 million and general public has 1 million).
 - Private company (worth \$800) with 8 million shares issued (Joe owns all the shares).
 - Public company wants to buy private—private wants to go public
- SEE AFTER SLIDE
 - Public has now taken-over private business—pubco buys privco on a **share by share basis** (privCo gives his 8 millions shares to pubCo in exchange pubCo issues 8 million shares to privCo)
 - Owner owns 80% of public company and essentially converted private business into public company. Board still has 1 million shares (10%), general public has 1 million shares (10%), and Joe has 8 million shares (80%)
 - Owner has taken private business public
 - End up with 2 corporations, pubCo owns privCo (the operating company)
- Looks like a regular take-over, and if values were tipped other way, it would be regular (he would only have 20% instead of 80%, but here because of relative values he stays in control)
- Some RTO transactions require s/h approval of PubCo.

Amalgamation

- Instead of RTO can do **Amalgamation**
- Take private and amalgamate with reporting issuer, the survivor is a reporting issuer. Rather than ending up with two companies, this transaction ends with a single company with the same share structure where the SH's own shares in the combined entity
- Amalgamation requires SH approval of both companies
- Information circular prepared will include prospectus-level disclosure
- Why Amalgamate:
 - With 1 SH or 2 SH, easy to do share-by-share exchange (RTO)
 - But with many s/h there are logistical and legal problems
 - If there are more than 50 s/h, takeover rules apply. Takeover rules state that if we do it as a purchase, every s/h must agree to the deal.
 - However, for an amalgamation you do not need 100% s/h approval. You just need 2/3 shareholder majority—remaining minority is forced to go along.
- SEE CHART IN SLIDES
- Note that fundamental changes, including amalgamations, give rise to the **right of dissent**
 - s. 184, ABCA – a SH may provide written notice of dissent and if they do, the C must buy the SH out and is obligated to pay market value for its shares
- Instead of acquisition you merge the public and private co and create an amalgamated co. which is a consolidation of both of them. The picture looks exactly the same as with surviving acquisition except we do not have 2 companies – we only have one b/c we have amalgamated the two together.

Three Corner Amalgamation

- More common than regular amalgamation
- Amalgamation requires approval of SHs of both companies
- Here, public company is not party to amalgamation. Instead, public co creates new wholly-owned subsidiary company and public company is only SH of its subsid
 - The transaction:
 - There are 3 companies: PrivCo, PubCo, and a new subsidiary corporation of PubCo (SubCo)
 - PubCo doesn't directly amalgamate with PrivCo, rather, PubCo forms SubCo which amalgamates with PrivCo. However, it is agreed that PrivCo gets shares in PubCo. So Joe owner of PrivCo has 80% control over PubCo, PubCo owns 100% shares of AmalgamationCo. See slides.
 - Why?
 - Amalgamation requires SH approval by special resolution, however with the SubCo, there is only one shareholder so it doesn't have to call meeting of all the SH's in PubCo. Also, PrivCo only has 1s/h so shareholder approval happens easily (just 2 shareholders)
 - No worries about the right of dissent
 - Further, if the SX requires approval from PubCo, it will only require a simple majority since PubCo itself is not being merged with PrivCo
 - ABCA does not permit for inter-jurisdictional amalgamations (AB privCo and BC PubCo—one would have to be continued into the others jurisdiction)
 - SubCo, is thus created in the same jurisdiction as PrivCo and you get around this ABCA impediment.
 - Result:
 - End up with the operating biz in SubCo, PubCo is protected from the liabilities arising from the operation of SubCo
 - PubCo can be kept as a clean shell – possibly future acquisitions

UNDERSTAND how amalgamation and 3 corner amalgamation work.

PART III: EXEMPTIONS FROM THE PROSPECTUS REQUIREMENT

Exemptions out of the Closed Box (sneaking out the back door)

(A)—Registration vs. Distribution

Requirements:

- *Act*, s. 75 – Under the closed system, the general rule is that no person can **trade** in a security unless they are **registered** (a registered broker)
 - Registration requirement: in order to trade in a security you must be registered (broker) with SC.
- *Act*, s. 110 – No one can **trade** in a security where it is a **distribution** unless that trade has been qualified by a prospectus (gets you out of the closed box)
 - Distribution requirement: cannot sell on the public market unless you issue a prospectus.

NI 45-106: Exemptions from Prospectus Requirements

- **Generally, the exemptions from having to file a prospectus are known as “private placements”**
- 45-106 creates a uniform exemption regime in Canada.
 - The exemptions used to be scattered amongst various rules, policies, etc
 - There are still some local variations but these variations are stated within the instrument itself. Ex. This exemption applies to everyone but ON, in ON they will do such and such.
- 45-304 points where more exemptions can be found in AB
- Significant Change to 45-106
 - Usually, the instrument provides for a “registration and distribution” exemption for certain transactions.
 - If exempt from registration requirement, it means that laypeople/co can sell shares w/o using a broker. However, if it only provides for a distribution exemption, then must still hire a broker
 - Now, all registration exemptions are grouped together in Part 3 and all distributions (prospectus) exemptions are grouped together in Part 2. Part 3 exemptions mirror the exemptions in Part 2. **This is because part 3 will be removed in its entirety soon. This means that there are no longer registration exemptions available for any of these transactions and that they can only be done thru a registered broker.**
 - Ex. A company/issuer that relies on exemptions to sell securities, that person now must be registered as a broker.
 - Exempt market dealer: creates a new category of broker--brokers only involved in exempt market transactions (aka private placements).
- On Mar 7, 2010: AB, BC, MB SK and territories are adopting their own exemptions. **It will be called Blanket order: 31-505. A person is exempt from the dealer registration requirement (you don't need to be registered as a broker) when trading in securities in connection with a distribution if you are relying on one of the 4 most common prospectus exemptions ((i) accredited investor; (ii) family, friends, and business associates; (iii) offering memorandum; and (iv) minimum investment amount) , but this is subject to a number of restrictions, namely that this person:**
 - cannot be registered (or be required to be registered) as a broker in any category of registration in any jurisdiction.
 - Business trigger for registration: if you are in the business of trading in securities, you are required to register in some category or another.
 - must not provide suitability advice about the trade to the purchaser (e.g. you cannot advise the purchaser on whether this is a good investment for them).
 - must not otherwise provide financial services to the purchaser (except in British Columbia) (e.g. if you act as mortgage broker for the purchaser, you cannot rely on this exemption to sell securities to that purchaser).
 - must not hold or have access to the purchaser's assets. This means that you cannot hold account balances for the purchaser, either in cash or securities, and should not receive or hold subscription funds.
 - must provide the purchaser with risk disclosure in the prescribed form (**risk acknowledgement form** must be signed by purchaser).

- This will ensure that the purchaser understands that you are not providing any suitability advice to the purchaser, they are investing at their own risk, and they are not receiving the same type and quality of advice or service that they would receive if they were dealing with a registered dealer or advisor.
- must file an information report with the ASC.
 - Name, address, who is responsible for supervising activities
 - Must be filed before purchase takes place or within 10 days after purchase takes place. File it once for all the purchasers for the specific exemption.

(B)--Private Place Exemptions NI 45-106

- Rationale Behind Exemptions: The investor doesn't need the information from the prospectus because:
 - He is sufficiently sophisticated, or
 - He can get the same type of information which is found in the prospectus from another source
- Provide exemption to a company where the purchaser has access to same type of information as a prospectus either cuz of relationship with company or his sophistication, or the existence of information from other resources, or where risk is very low.
- Five Categories of Exemptions:
 - (1) Capital Raising Transactions
 - (2) Transaction Divisions
 - (3) Investment Fund Exemptions
 - (4) Related Parties Exemptions
 - (5) Miscellaneous Exemptions

(1)--Capital Raising Exemptions

- Want to raise money for a company but don't want to file a prospectus. There are 8 capital raising exemptions.

s.2.1: Rights Offerings

- What is a rights offering: a corp exists and has issued many shares, these shareholders hold different number of shares, a rights offering is when a company says to its existing shareholders every share that you have gives you the right to buy more shares (**rights offering = an option to buy more shares**).
- A rights offering is a method of issuing more shares just to existing s/h. This is a distribution and registration exemption.
- Rights offering will be typically at a lower price--want to give a deal to our existing s/h.
- Requirements:
 - Must give prior written notice about the rights offering to the SC; the SC then has 10 days to object
 - Must comply with NI 45-101
 - (i) Amount:
 - C cannot use the exemption to ↑ outstanding shares by >25%
 - C cannot offer rights on greater basis than 1 to 4 (IE: For every 4 shares you have, we offer you the right to buy 1)
 - (ii) Timing:
 - Rights must be left open for at least **21 days**
 - Limit on how long you can keep open:
 - Max time period depends on whether the rights offering is subject to a minimum subscription or not.
 - If the C sets the minimum amount of \$ to be raised, then cannot leave open for more than **45 days**
 - If the C doesn't set a minimum, the rights offering must close within **90 days**
 - Can't be more than a 25% dilution

- Rationale for exemption: these are not new investors, these investors already know enough about the company, this is why we don't require a prospectus, they already know about the company. Just provide them info about the new deal.

s.2.2--a Dividend Reinvestment Plan (DRIP)

- Company will say: whenever we pay a cash dividend out to you, if you don't want the cash and instead you want to reinvest this cash, we will keep it and use it to buy more shares for you (reinvest it in the company)
- Each share issued to EE will be an issuance out of treasury and a distribution – if this process was not exempt, every distribution would require a prospectus.
- Rationale: exempt cuz we are dealing with existing shareholders. Already know this company.
- Limits on dividend reinvestment plan
 - Where a plan allows you to make an additional cash contribution to the DRIP then total number of shares cannot be more than 2% of your total outstanding shares at the beginning of the year.

2.3--Accredited Investor

(1 of the 4 most common exemptions covered by blanket order providing **registration exemption**)--KNOW THIS ONE

- **If buyer is an accredited investor then issuer does not need to file a prospectus (Prospectus exemption)** or any other type of disclosure. So this is a registration and distribution exemption.
- **Who is an accredited investor, it includes:**
 - **Financial assets test:** an individual that has “financial assets” (cash and securities) of at least \$1,000,000
 - Financial assets means cash and securities. This is NOT a net worth assessment (doesn't include their house). Just look at their cash and investment portfolio. This is a net value (so if LOC is secured against some of their term deposits then you have to take this debt into account but you don't take into acct a mtg that is not secured against the cash or term deposits)
 - an individual who has a before tax net income (in the last two years) of at least \$200,000 (or \$300,000 combined with spouse) and reasonably expects to exceed that income level in the current calendar year
 - a company that is wholly owned by one or more accredited investors or has net assets of \$5,000,000.
 - Others: Registered brokers; Chartered banks; Charitable institutions; People been registered as brokers in the past
- **REQUIREMENT: the accredited investor must purchase as principal** (they are making the investment for themselves--not acting as an agent for someone else). The trade is only exempt if the AI purchases for himself.
 - **Exception to this requirement—fully managed accounts (FMA) s.1.1(q)**
 - A person operating a fully managed account is deemed to be purchasing as principal when purchasing on behalf of that FMA. In an FMA, the (registered) broker has authority to make investment decisions without getting approval from his clients. In this circumstance, we allow the broker to buy and pretend he is buying as principal.
- Rationale: this people are complete strangers, don't know my company. 2 rationales: (i) someone who has a million in cash will likely be sophisticated; and (ii) if they have that kind of money they can afford to lose some of it.
- Don't have to provide any info to an accredited investor, but if you do prepare some sort of disclosure requirement then it must meet the requirements of an offering memorandum and a right of rescission. So as a general rule, don't prepare any material for investors. Just have a subscription agreement (you are buying shares in this company).

s.2.4--Private Issuer

- A private issuer is exempt from filing a prospectus (prospectus exemption). Private issuer is a private company.
- **What is a Private Issuer:**
 - i) is not a reporting issuer (pubco) or an investment fund,
 - ii) its securities (the company's own securities), other than non-convertible debt (like bank loans):
 - a) are subject to transfer restriction (doesn't matter what kind of restrictions just that there are restrictions, ex. Transfer requires BOD approval) contained in the issuers constating documents or shareholders agreement (USA); and
 - b) are held by not more that 50 people, not including employees and former employees; AND

- (iii) has only distributed securities to the permitted list of investors (if I am a private issuer I can issue shares provided that the people I issue shares to are one of the following types of people):
 - director, officer, employee, founder (this is similar to promoter—a founder is someone who founds the business + still involved in the business) or control person of the company
 - spouse, parent, grandparent, brother, sister, or child of either a director, senior officer, founder or control person or of a spouse of such director, senior officer, founder or control person
 - close personal friend (see below for examples) or close business associate of a director, senior officer, founder or control person
 - spouse, parent, grandparent brother, sister or child of the selling shareholder or the selling shareholder's spouse
 - a current shareholder
 - an accredited investor (thus this person can be a complete stranger—aka angel investor)
 - a company of which a majority of the voting shareholder or of the directors are persons described above
 - **a person that is “not the public”**
- **2 CL tests to determine “who is the public”**
 - **Need to Know Test** from *SEC v. Ralston Purina* (US case)
 - Wanted to set up an EE share purchase plan.
 - SEC held that Purina is distributing shares to the public. Company: the shares are not available to the public, it's only available to our EE's.
 - What is the rationale for a prospectus (informed decision), does anyone in this group need to know info that is made available in a prospectus or do they already have this info?
 - Although senior management may have the sophistication / access to information which a prospectus would normally make available allowing for a fully informed decision, the lower level E'ee's did not have access to this information and therefore, would “need to know” the information contained within a prospectus.
 - **Therefore, if you are a person that “needs to know” then you are a member of the public.**
 - Also, the court indicated that a “public” offering need not be made available to the whole world – could be an offer to a discrete group of people; as long as one person is a “member of the public”, the offering will be an offering to the public → no quantitative limit
 - **Common Bonds Test** from *R. v. Piepgrass*
 - Promoter raised \$50K from farmers whom he knew and had dealt with before
 - Alta CA said these farmers were the “public” as they “were not in any sense friends or associates of the accused, or persons having common bonds or interests of association.” The investors were members of the public b/c they did not have common bonds of interest or association with the seller, and they were not friends or associates.
 - **Two TESTS as to what is meant by “common bonds”:**
 - 1. In a relationship that is sufficiently close, there will be a high degree of mutual trust:**
 - The friend will give the promoter money with no questions asked and the promoter will not get his friends into a bad deal
 - 2. Relationship is close enough that you have sufficient common bonds that if you wanted to get information, all you would have to do is ask**
 - Then all of the financial info would be made available. Promoter will not take advantage of people that he has common bonds with/deals with on a regular basis.
 - **Rule of thumb** – it is not a member of the public if it is a close personal friend or close business associate.
- What is a close friend: people who went to high school together and still stay in contact with each other; Go on family vacations together; Play cards together; Do community activities together; Social activities together
- Cannot pay any commissions or finders fees for any sales of shares for a private issuer. Bob, Officer of XYZ, finds Frank to buy shares, XYZ can't pay Bob a finders fee.

s.2.5—Friends, Family and Business Associates

(1 of the 4 most common exemptions covered by blanket order providing **registration exemption**)

- Where the buyer fits within one of the categories the seller does not have to file a prospectus (**prospectus exemption**)

- Registration and prospectus requirement does not apply to a trade in securities **to a person who purchases security as principal if they are one of the following:**
 - a) a director, executive officer or control person of the issuer or an affiliate of the issuer;
 - b) a spouse, parent, grandparent, brother, sister or child of a director, senior officer or control person;
 - c) a parent, grandparent, brother, sister or child of a spouse of a director, senior officer or control person;
 - d) a close personal friend or a close business associate of a director, senior officer or control person;
 - e) a founder of the issuer or a spouse, parent, grandparent, brother, sister, child, close personal friend or close business associate of a founder;
 - f) a parent, grandparent, brother, sister or child of the spouse of a founder
 - g) a company of which the majority of the voting securities are owned by, or a majority of the directors are, persons described above; and
 - h) a trust or estate of which all of the beneficiaries are or a majority of the trustees are persons described above.
- Rationale: Not dealing with public, they are close enough to us that they can get the info that they need.
- Why have 2 exemptions that look the same (2.5 and 2.4)? 2.5 does not require you to be a private issuer. Thus, pubco/reporting issuer could fall under this exemption (president wants to sell shares to his spouse).
- No limit to the amount of people you could sell under this exemption.
- Stacking principle: a company uses more than one exemption. If you stack exemptions, make sure one does not taint the other. 2.4 can't be stacked with 2.5 cuz private issuer conditions can't work with 2.5 pubco.

2.8--Affiliate

- Issue securities to an affiliate who is purchasing as a principal. What is an affiliate: subsidiary, sister company, parent. No prospectus requirement for distributions between parent, subsids and sister company.

2.9--Offering Memorandum (this is basically an abbreviated prospectus)

(1 of the 4 most common exemptions covered by blanket order providing **registration exemption**)

- **Can issue securities to any number of people of any qualification (they can be dirt poor) as long as we have prepared an OM in the prescribed form. If seller does OM, don't have to file a prospectus.**
- **Requirements:**
 - The company must prepare an OM in the form mandated by the instrument.
 - it is similar to a prospectus (must present a lot of the same info). The purchaser will not be fully informed but relatively well informed.
 - There is no limit on the number of investors that can participate.
 - There is no limit on how often you use the exemption (can do as many OM's as I want).
 - In Alberta (and some other provinces), if a purchaser invests more than \$10,000, they must be an "eligible investor"...so if a purchaser invests more than 10K then they must be an eligible investor:
 - Eligible investor: someone that has obtained advice from an independent investment dealer or securities dealer (just have to talk to them—could have told you not to invest), OR has net assets of \$400,000, OR pre-tax income (in past two years and expectation to continue in current year) of \$75,000, or \$125,000 combined with a spouse.
 - A two day right of recession: purchaser cuts chq to company, co has to hold chq on trust for 2 days before they cash it, purchaser can cancel it before then.
 - Each subscriber is required to complete a risk acknowledgement form.
 - This is distinct from which exempt sales person makes purchaser sign. So a purchaser may have to sign 2 of these--this is a different risk acknowledgement form.
 - There is a right of action for rescission or damages in the event of a misrepresentation in the OM.
 - rescission: have 180 days of signing the agreement to start the claim
 - damages: the earlier of 180 days of learning of the misrepresentation or 3 years after signing the purchase agreement.
- Why do this? An OM does not need to be approved by SC, but it does need to be filed with SC within 10 days after you complete the first sell. They don't review it or approve it, just filed there for information purposes.
- This exemption is available to an issuer distributing shares of itself--of its own securities. It does not cover sales of securities of somebody else's shares--a resale.

- Ex. Sale by a control person, any sale by him is deemed to be a distribution, when he goes to sell them he can't use OM exemption.
- Also, you can't rely on the Offering Memorandum exemption in ON or friends and family exemption.
- In AB, if the security you are offering is a real estate security (an investment K dealing with a real estate project-- Land Development Case), then there is a different form of OM that you must use-->45-509

2.10--Minimum Investment

(1 of the 4 most common exemptions covered by blanket order providing **registration exemption**)

- Individual purchases as principal where the acquisition cost is not less than \$150,000 paid in cash on closing. It has to be all paid in cash (NOT a promissory note) upon the closing of the transaction.
- Logic: if someone is writing a chq for 150K they know how to look after themselves.
- No prospectus is required, but if seller does put it together it must meet the requirements of an offering memorandum which includes the right of rescission. So don't prepare any material.

(2)--Transaction Exemptions

The following exemptions are not needed to raise money, but are needed to complete certain deals. These exemptions facilitate transfers such as share/asset exchanges.

- **s.2.11--Business Combination and Reorganization**
 - Don't have to make a prospectus if there is a distribution of securities in connection with:
 - An amalgamation, merger, reorg, or arrangement **under a Statutory procedure**—(such as a plan of arrangement under the BCA **or**
 - An amalgamation, merger, reorg or arrangement that is described in **an info circular and** is approved by the security holders, or
 - A dissolution or winding up
 - **Exempts any issues of securities in connection w/ one of these transactions.** There might be a variety of securities of different companies involved such as a 3 cornered merger or exchangeable share transaction.
- **s.2.12--Asset Acquisition**
 - prospectus requirements do not apply when securities are issued in exchange for assets having a value of at least \$150K. Assets instead of cash like real estate traded for shares.
- **s.2.13--Petroleum, Natural Gas and Mining Properties**
 - prospectus requirements do not apply when securities are issued in exchange for PNG properties. This exemption does not have a minimum value requirement. There are no conditions. This is a common business transaction→interest in company in exchange for PNG property.
- **s.2.14--Securities for Debt**
 - prospectus requirements do not apply when a reporting issuer issue its own securities to a creditor to settle a bona fide debt. It must be a bona fide debt.
- **s.2.15--Issuer Acquisition or Redemption**
 - Company buys its own shares back, can do this without filing a prospectus. Ex. sold shares to Joe, Joe is a control person, Joe selling them back to me is a distribution don't have to file a prospectus
- **s.2.16--Takeover Bid and Issuer Bid**
 - All trade of securities in connection with a takeover bid and issuer bid are exempt
 - Issuer bid is when a company is offering to buy back its own shares
- **2.17--Offer to Acquire to Security Holder Outside Local Jurisdiction**
 - If I make takeover bid to buy all shares of a company it is exempt. But US has different takeover rules. Ex. 80% of s/h are in Canada, but 20% of s/h in US. This section allows me to come up with a plan of buying shares from s/h who are outside the local jurisdiction.

(3)--Investment Fund Exemptions

These exemptions are only available to mutual fund companies and non-redeemable investment funds.

- **s.2.18--Investment Fund Reinvestment:** just like dividend reinvestment one above. Not allowed to charge any sales fees for that reinvestment. Prospectus requirements do not apply to an investment fund which allows a co to offers its SHs a dividend reinvestment
- **2.19--Additional Investment in Investment Funds**
 - Additional investment where initial minimum investment of 150K is made and continued. If someone originally invested minimum of \$150K, they can make new investments of a smaller amount and additional investments are not subject to the prospectus and registration requirements.
 - Have to maintain at least 150K to rely on this exemption. This only applies to investment funds.
- **2.20--Private Investment Club**
 - Can form a club to pool money to invest as long as: it has less than 50 issuers; has never sought to borrow money or distributed securities to the public; cannot pay any investment management fees except normal brokerage fees; members required to contribute to the costs of the fund on a basis proportionate to the value of the securities they hold
- **2.21--Private Investment Fund--Loan and Trust pools**
 - The prospectus and registration requirements do not apply wrt a trade in a security of an investment fund if the investment fund is
 - administered by a Trust co registered in Cda under Trust Co legislation
 - has no promoter/manager other than the Trust co, and
 - co mingles the money of different estates and trusts for the purpose of facilitating investment.

(4)--Employee, Executive Officer, Director and Consultant Exemptions

- Consultant = someone who is engaged in business of the company with a K...people who are not EE's but are using a management company to do business with a company (PC is under K with the firm not the owner of PC)
- We include consultants so individuals providing services thru PC receive benefits without being an EE.
- This Part provides exemptions from having to file a prospectus when issuing shares to the following named people
- **2.24--Employee, Executive Officer, Director or Consultant**
 - Can issue shares to them without having to file a prospectus so long as the trade is voluntary (can't be a condition of their employment in any way)
 - Also permits trades of those securities to a "permitted assign":
 - Trustee is acting on my behalf
 - Holding entity is acting on my behalf
 - RRSP or RRIF
 - Spouse
 - Trustee, holding entity, RRSP or RRIF of spouse
- **2.25--Unlisted Reporting Issuer Exception**
 - This exemption is almost the same as 2.24 yet adds in a percentage cap; the percentage cap does not appear in 2.24 b/c the stock exchanges already regulate the percentage. Places limits on use of exemptions by unlisted companies (companies that are not listed on stock exchange). Unlisted co can still issue securities to employees, but within limits. If you grant option to a related party, must either have certain restrictions on options to related parties or have option plan approved by s/hs on majority of minority basis
- **2.26--Trades Among Employee's of Non-Reporting Issuer**
 - Dealer registration and prospectus requirements do not apply to trades b/n the issuer and
 - a current or former EE, executive officer, director, or consultant of the issuer or related entity of the issuer, or a permitted assign of a person referred to in para (a)
 - Exemption is only available if
 - participation in the trade is voluntary
 - the issuer of the security is not a Reporting Issuer in any jurisdiction of Cda, and
 - the price of the security being traded is established by a generally applicable formula contained in a written agreement (ex. s/h agreement). if you are EE and you leave, you can sell them to a current EE in the company based on this formula.
- **2.27--Permitted Transferees**
 - Trade from an ER to permitted assigns or between permitted assigns

- **2.28--Re-Sale/Non-Reporting Issuer**
 - Primarily used to address the situation where you have a non Cdn co that has a division in Cda with a number of Cdn EE participating in the share participation program. The dealer registration requirement does not apply wrt a resale of a security that was acquired under this Division or by a person described in s.2.24(1) if the conditions in s.2.14 of NI 45-102 are satisfied:
 - Not a reporting issuer
 - Less than 10% of the shareholders are Canadian (by both number of shares and number of bodies)
 - The sale takes place on a market outside of Canada
 - Then they can sell the shares WITHOUT having to file a prospectus.

(5)--Miscellaneous Exemptions

- **2.30 Isolated Trade**
 - No requirements and no disclosure and no limit on how many times you can rely on it
 - Prospectus requirements do not apply wrt a trade by an issuer in a security of its own issue if the trade is an isolated trade and is not made
 - in the course of continued and successive transactions of a like nature (an isolated trade), AND
 - by a person whose usual business is trading in securities.
 - If it is a one time transaction, then use this exemption
- **2.31--Dividends and Distributions**
 - Cash is not a security.
 - dividend in kind exemption: the prospectus requirements do not apply in respect of a trade by an issuer in a security of its own issue to a security holder of the issuer as a dividend or distribution out of earnings, surplus, capital or other sources.
 - a dividend, or other distribution, that is paid in securities of the issuer's own securities – co. made money and wants to pay a dividend but not with cash b/c they want to use cash for reinvestment so they re buy shares in co. and pay out to SH – do not need to be a RI to do this but status will impact hold period.
 - Dividend in Specie – the prospectus requirements do not apply in respect of a trade by an issuer to a security holder of the issuer in a security of a reporting issuer as an in specie dividend or distribution out of earnings or surplus.
 - A Co may distribute shares of B Co; as long as B Co is a RI, this exemption will work. Other issuer MUST be a RI. We use this exemption when doing a clone deal.
- **2.32--a Trade to a Lender by a Control Person for Collateral**
 - Control person can go to bank and pledges shares--bank hold shares in collateral for a loan. No prospectus required for this transaction. However, if lender doesn't get paid and he sells the shares then the lender's sale would be a distribution and would be required to file a prospectus.
- **2.33-Acting as Underwriter**
 - The prospectus requirements do not apply in respect of a trade in a security between a person and a purchaser acting as an underwriter or between or among persons acting as underwriters. A broker in a bought deal buys the shares from the issuer, so when he turns around and sells them to his clients this is a distribution. No prospectus required.
- **2.34--Guaranteed Debt**
 - Exempts trades in debt that is guaranteed by a govt or financial institutions. This allows banks to sell me GICs or govt bonds and T-bills. These are guaranteed, there is no risk so no disclosure by prospectus
- **2.35--Short Term Debt aka Commercial Paper**
 - Company can sell these short term notes without having to file a prospectus.
 - The prospectus requirements do not apply in respect of a trade in a negotiable promissory note or commercial paper maturing not more than one year from the date of issue, if the note or commercial paper traded
 - (a) is not convertible or exchangeable into a right to purchase another security, and
 - (b) has an approved credit rating from an approved credit rating organization
- **2.36--Mortgages**
 - Exempts distributions of mtgs by a licensed mtg broker (they don't have to file a prospectus)
- **2.37--Personal Property Security Act**
 - This allows normal secured loan transactions as long as they are not sold to individuals.
- **2.38--Not for Profit Issuers**

- So long as investor gets no return on the earnings. Basically purchaser is making a gift, this is how they sell memberships. Let charities raise money without having to file a prospectus.
- Security holder gets no benefit from net earnings. No commission is paid.
- 2.39--he doesn't understand these
- **2.40--RRSP/RRIF**
 - The prospectus requirements do not apply in respect of a trade in security between
 - (a) an individual or an associate of the individual, and
 - (b) an RRSP or RRIF
 - (i) established for or by this individual, or
 - (ii) under which this individual is a beneficiary
- **s.2.41--Schedule III Banks and Cooperative Associations** (allows banks and coops to take deposits)
- **s.2.42--Conversion, Exchange or Exercise (this is an important exemption)**
 - This exemption exempts the conversion or exchange of previously issued securities.
 - Ex. If i grant a stock option to my EE, the grant of that option is a distribution (an option is a security), EE exercises that option (he is in fact disposing of the option and he is purchasing shares). When i issue shares after this, i have distributed shares to him. The exercise of that conversion right is another distribution. If this guy is no longer an EE when he exercises it then use this exemption when he converts the option (the 2nd distribution). Company does not have to file a prospectus for this 2nd distribution.

Exchange Offering Document (Part 5)—Short Form Offering Document (SFOD)

- Only available to companies listed on TSX-Venture
- Cross b/n offering memorandum and prospectus, must comply with TSX-V and its vetted by TSX V; only gets reviewed by stock exchange so review time is less than for offering prospectus.
- In order to use this exemption co. must have filed annual information form [AIF].
- The shares are free trading, except:
 - shares purchased by insiders
 - purchasers over \$40K
- Limits: No more than 2 million can be raised in total (in entire lifetime of company, can't raise more than 2 million doing this). SFOD is like a short form prospectus. It incorporates by reference other docs.

Exemptions contd

- 4 most important: OM, friends and family, accredited investor, minimum investment.
- Registration exemptions will disappear soon except in western Canada where local blanket orders will bring back the registration exemptions for these 4 most important exemptions (subject to the things discussed last class).

(C)--Reporting Requirements

If you used an exemption what next--Part 6.1 of 45-106 sets out Reporting Requirements.

- If you use some exemptions the SC will require you to file a "**report of exempt distribution**" pursuant to 45-106F1
- s.6.1 of 45-106: sets out which exemptions are required to file this report.
- s.6.1(2): The issuer or underwriter must file the report in the jurisdiction where the distribution takes place no later than **(within) 10 days after the distribution**.
 - Distribution aspect: Private placement with OM. Investors give company chqs. Company holds onto these chqs until they raise the minimum subscription. So the company is engaging in trades for a number of days before they close. Close = company issues share certificates to shareholders and accepts their subscriptions...this is the day which the distribution takes place. Closing date is the trigger date to file the report.
 - The form asks you what is the name of the company, what is date of trade, what business you are in, what securities and how many have you issued, how exemptions are you relying on, names and addresses of investors. This form is a public doc (except for the personal info of investors).

(D)--Discretionary Exemptions--Part 7

- This gives power to SC to grant an exemption to the instrument
- s. 144(1) of SA – The Commission may, if the Commission considers that it **would not be prejudicial to the public interest** to do so, make an order exempting a trade from section 75 or 110
 - **s.144 of the Act gives SC discretionary authority to exempt any person from prospectus requirement.** Order can be made on application of any interested party and can be made on motion of SC itself (usually by way of blanket order which will apply to everyone. Ex. SFOD). “I want an exemption but I don’t quite fit within any of the exemptions”
 - SC will not grant order if it would be prejudicial to the public interest (capital markets or investors are not going to get hurt). We are NOT saying that it is in the public interest to invest.
 - Order is typically granted where requirements have been substantially complied with (Ex - there is an exemption available for trades with a minimum price of \$150,000; if you have investment opportunity with price of \$145,000 you can make argument that same criteria are met (a person who can cut a 150K chq does not need protection, a person who can also cut a chq for 145K does not need protection → the rationale for the exemption still applies in this situation).
- SC also has power to deem a particular trade to be a distribution--deny your ability to use an exemption
- One off transaction: this is a transaction that will never pop up again and there are sophisticated parties and we need an exemption from the prospectus.
- **144(5): SC has an authority to make an exemption order retroactive → applies back to the date of the illegal distribution.** This is unique to AB. If you have a client that has made an illegal distribution and wants to get it white washed can go to SC and confess--we want exemption order to be retroactive back to the date of this illegal distribution.

(E)--Re-Sale Restrictions--45-102

- 45-106 exempts distributions of securities (selling shares out of treasury). When I buy shares thru a prospectus, those shares are liquid cuz the registration gets the shares out of the closed system.
- **When I sneak out back door with an exemption, the securities are issued but get caught in a waiting room known as 45-102. Restrictions are imposed on resale of securities (which were originally purchased thru an exemption) by deeming that the resale is a distribution.** Therefore, I can’t resell these shares cuz they are not out of the closed system yet.
- Therefore, where securities have been distributed by way of an exemption, the first trade of those securities is deemed to be a distribution, unless the conditions of 45-102 have been complied with → the restrictive period or seasoning period has been satisfied. In other words, I've acquired shares thru private placement I can’t resell them unless the restrictive period is satisfied or the seasoning period.
- Which applies (restrictive or seasoning) depends on which exemption you used. s.2.5 of 45-102 is restrictive period. s.2.6 is seasoning

Restricted Period—s. 2.5

- If an exemption is subject to s. 2.5 (appendix D sets out exemptions that are subject to restricted period), in order to resell the securities, requirements for 2.5 must be satisfied:
 - Purchaser must have owned the shares for at least 4 months + 1 day AND
 - The issuer must have been a reporting issuer for 4 months in any jurisdiction in Canada.
- So the 4 months hold period will run from the later of the distribution date or the date that the company becomes a RI (in any jurisdiction in Canada). This means that if I have purchased shares in a co. that is not yet a RI, my restricted period/hold period will not start running until co. becomes RI. Until co. goes public the shares will be subject to an indefinite hold period that may never expire.
 - If I’m a RI in ON then someone in BC gets the benefit of that status.

Seasoning Period—s.2.6

- With exemptions that are only subject to seasoning period it does not matter how long you have owned them as long as company has been reporting issuer for 4 months.

- 2.6 does not give rise to a restrictive period so long as the shares are seasoned (the company has been a RI for at least 4 months). So the date company becomes RI is the relevant date. If I acquired my shares after their 4 months then there is no hold requirement, I can sell immediately.
- Appendix E lists exemptions subject to seasoning period.

Additional conditions that have to be met in order for s.2.6 and s. 2.5 to be satisfied:

- No unusual effort to create a market for the securities.
 - Can't launch 50K investment campaign saying how great these securities are.
- There can be no extraordinary commission paid in relation to the sale.
- The share certificate must bear a legend in the prescribed form. When a company issues a share, it must print this on the certificate: these securities cannot be traded until _____
- If person selling the shares is an insider or officer of the company they must have no reason to believe that the issuer is in default of its reporting requirements (securities regulations).
 - If you are just a Joe Schmuck seller then this condition does not apply. But if you are director of company and you are selling shares that you acquired under exemption, if you know that company is in default, then you are not allowed to sell shares during that time.

NI 45-102 also controls "Distributions by control persons"

- Seasoning periods and restrictive periods do NOT apply to a control person. By defn of distribution any sale by control person is a distribution (need to file prospectus or rely on exemption).
- How do I resell shares I purchased thru an exemption if I am a control person (seasoning and restrictive don't apply to me). Control person relies on s.2.8. **Control person can resell if he satisfies the following conditions:**
 - The company has been a RI in Canada for at least 4 months.
 - Must have held the securities for at least 4 months. The shares I am selling specifically I have had to have for 4 months.
 - Made no unusual effort to create a market
 - No extraordinary commission from consideration paid wrt the trade
 - Must have no reasonable grounds that the company is in default of the securities legislation.
 - **I must file a notice of intention to distribute—45-102F1**
 - It must be filed within 1 business day of it being signed. I am certifying that company is not in default.
 - Must be filed at least 7 days before I start selling shares. I file today, the earliest i can sell is March 8th. I have to say how many shares i want to sell, how am i going to sell (over the market or privately). This notice expires after 30 days. If you don't sell all that you want, file another one. Can't have 2 at same time, so you would have to wait 7 days in between the two.
 - This allows world to see that president is dumping his stock in the company. Prevents control person from selling before anyone else.
 - Control person must also file an insider report within 3 days (days not business days) using this system (typically it is 10 days for insiders).

PART IV: CONTINUOUS DISCLOSURE NI 51-102

- **Becoming a RI, one becomes a RI (we've escaped closed box):**
 - Most likely by filing a prospectus (listed on prescribed stock exchange)
 - Amalgamating with a RI
 - Being declared a RI
- **Once a company is a RI it must meet continuous disclosure requirements.** If not a pubco (RI) then not subject to continuous disclosure requirements.
- Most continuous disclosure requirements are in 51-102, a few others are scattered in other NI's.

- **Venture Issuer:** is an issuer that, at the applicable time, did **not** have any of its securities listed or posted on any of the Toronto Stock Exchange, a U.S. marketplace (Nasdaq Stock Market or “national securities exchange” in the U.S.) or a marketplace outside of Canada and the U.S.
 - **As a VI you get some continuous disclosure breaks** (VI’s are typically junior companies).
 - If you have shares that are listed on TSX you are **not** a VI. So you are a VI in any other case (shares aren't listed at all, or listed only TSX-V).

(A)--Financial Disclosure

- This includes financial statements, MD&A, officer’s certificate, audit committee disclosure

(1)--Financial Statements (Part 4 of NI 51-102):

(a) Year end statements (s. 4.1, 4.2 of NI 51-102)

s.4.1 imposes requirement on RI’s to file yearend financial statements complete with comparative statements for prior year; deadline for filing depends on what type of co. you are

(i) **Venture issuer: 120 days** from the end of its yearend (must file its year end statements by then). Dec 31 is year end so must file by April 30.

(ii) **Non-venture issuer: 90 days**

- **Year end financial statements must be audited and must be accompanied by an audit report.** NI 52-107 sets out the standards for these audit reports.
 - **Financial statements** must be in accordance with Generally Accepted Accounting Principles (GAAP)
 - **Audit statements** must be done in accordance with General Accepting Auditing Standards (GAAS).
- What is Canadian GAAP going to change? Canadian Accounting Standards Board has declared that the financial years beginning in Jan 1, 2011 public enterprises will be required to prepare their financial statements in accordance with International Financial Reporting Standards (IFRS).
 - A year financial statement has 2 columns: Dec 31, 2009 (previous year) and Dec 31, 2010 (current year) done in Canadian GAAP. 2010 numbers must also comply with IFRS for the 2011 year. So 2010 numbers will be done in GAAP and IFRS.
 - IFRS: Notes to financial statements is the big difference. IFRS requires much more info.

b) **Interim statements:** (s. 4.3, 4.4 of NI 51-102): during the year a RI must report for each interim period (each 3 month quarter). 4th quarter is year end so don't have to file an interim statement for the 4th quarter. Quarter = 3 month period. If year end is Dec, quarters will end Mar 31, June 30, and Sep 30

(i) **Venture issuer:** deadline to file interim statement is **60 days** after quarter end

(ii) **Non-venture issuer: 45 days**

- Interim Financial Statements do not need to be audited, but RI must disclose if they have not been “reviewed” by the auditor. If they did, then they have to provide a "review report". If not reviewed must state this on the front of the interim statement.

Delivery requirement

- Financial Statements and interim statements must also be sent to shareholders that request a copy (s. 4.6).
- Every year RI must send shareholders a request form pursuant to the provisions of NI 54-101. known as a supplement mail list card. If you want to get financial statements for the company, send in this form and will put you on our mailing list.
- In conjunction with financial statements, company must prepare MD&A.

2. Management Discussion and Analysis--(MD&A) (Part 5 of NI 51-102)

- MD&A is a discussion of the RI’s financial statements—it explains why you made money this year as compared to last year.
- Must prepare and file MD&A for each set of interim and annual financial statements. **Filing deadlines are the same as for the financial statements→they must be filed together.**

- Must be filed by the earlier of the deadline for filing the financial statements or the date that the financial statements are actually filed
- MD&A must also be sent to requesting shareholders with the financial statements.
- They must be prepared in accordance with Form 51-102F1, and to include information required by s. 5.3 and 5.4.
- MD&A must also discuss any recent or proposed changes to accounting policies **and the impact it will have on the company**. Any changes voluntarily made or made pursuant to policy (like GAAP being changed to IFRS).

3. **Officer's certificate**--(MI 52-109) Multilateral Instrument

CEO and CFO must certify the financial statements of public companies that:

- The financial "filings" do **not** contain a misrepresentation, **and**
 - the financial "filings" "**fairly present**" in all material respects the "**financial condition**" of the issuer.
- This is different than what accountants certify in accordance with GAAP. Accountants look at "financial position", CEO and CFO certify wrt "financial condition".
 - Ex. Canadian GAAP must be booked at their lower realizable value (bought a piece of property 10 years ago for 1 million, today it is worth 5 million, the financial statement will show at best a million dollars cuz that is what they bought at--doesn't reflect real value of the company).
 - MD&A should discuss why financial statements do not reflect real value of company.
 - **Financial filings includes financial statements and MD&A -- certifying that everything I file in connection with those statements is a fair presentation.** Sometimes companies will use non-GAAP measures to do this.
 - Measures that are not officially sanctioned by accounting standards. Ex. EBIIDA (earnings before income taxes depreciation and amortization). It gives you a better understanding of a company's cash flow.
 - If you use non-GAAP measures in your financial reporting (usually in MD&A) you must clearly state that it is a non-GAAP measure and explain how you calculate it and you must reconcile it to the actual GAAP measures.
 - This certification scheme has been designed to prevent the Enron / WorldCom scandals, where the high ranking officers plead ignorance as to what was in the FS.
 - **2 different forms of officer certificates** (which one a company uses depends on if you are a VI):
 - **Non-venture issuer** must certify that those officers have designed disclosure controls and procedures (DC&P), and internal controls over financial reporting (ICFR). Must indicate which control framework that they use.
 - DC&P: These are policies that you set in place that ensures executive officers get access to material info (ex. certain events must be reported up to CEO)and that this info is disclosed in a timely manner.
 - ICFR: Accounting procedures put in place to ensure that its financial reporting is accurate and timely.
 - MD&A must disclose any material weaknesses in your controls. And must state that they evaluate the effectiveness of those controls every year.
 - **Venture issuers** can exclude DC&P/ICFR certification, **but then must include risk warning.**
 - A VI officer certificate is known as a "basic certificate" or "bare certificate".
 - CEO and CFO must still certify that financial filings don't contain any misreps and is fair. But this certificate must include a disclaimer that says you can't rely on the accuracy or timeliness of our disclosure.
 - A VI can use the long form certificate but if they do they must satisfy more requirements (very few VI will do this).

4)--**Audit Committees** (NI 52-110)

An audit committee is a requirement of corporate and securities legislation. ABCA's requirements are less stringent than NI 52-110

ABCA 171(2) The audit committee of a distributing corporation must be composed of not less than 3 directors of the corporation, a majority of whom are not officers or employees of the corporation or any of its affiliates.

(a) **Composition** (Part 3 of NI 52-110) of an audit committee must be

- at least 3 persons (and every member must be a director)
- each member must be independent (s.1.4)

(iii) Each member must be “financially literate” (s. 1.5)

- Audit committees are required to review and approve financial statements (continuous disclosure obligations) of company before they are approved by BOD.
- **Independence (s.1.4)--what does this mean**
 - **You are independent if you have “no direct or indirect material relationship” with the company**
 - **Material relationship: a relationship which could, in the view of the issuer’s Board of Directors, reasonably interfere with the exercise of a person’s independent judgment.**
 - The following relationships are deemed to be in a material relationship (**not** independent) (people who are in this relationship or were in this relationship in the past 3 years)—s.1.4(3)
 - An EE of the company (if you are an EE or were in the past 3 years you are not independent)
 - An executive officer is not independent
 - Immediate family member of an executive officer
 - An affiliated entity, partner or employee of the current or former internal or external auditor
 - An immediate family member of a person described above
 - If an executive officer of the Corporation serves on another company’s audit committee, then the executive officers, and their family members, of that other company will not be independent
 - A person if they or an immediate family member of a person is an executive officer of another company where any of the issuer’s executive officers serve on the compensation committee of that other company.
 - If you are on compensation committee you decide how much pay to pay officers
 - A person who may accept, directly or indirectly, any consulting, advisory or other fees from the Corporation or its subsidiaries, except for directors’ and committee members’ fees
 - Any person who receives, or whose immediate family member receives, more than \$75,000 per year in direct compensation from the Corporation, other than directors’ fees and committee members’ fees
 - Compensation does not have to be salary, could be consulting fee (like a lawyer or accountant). If this person gets more than 75K compensation you are not independent.
 - An individual that is an affiliated entity of the Corporation or a subsidiary
- **Financial Literacy (s.1.5)--what does this mean:**
 - An individual is financially literate if they have “the ability to read and understand a set of financial statements that present a breadth and level of complexity of accounting issues that are generally comparable to the breadth and complexity of the issues that can reasonably be expected to be raised by the issuer’s financial statements.”
 - Key issue to take away from this: this applies to the issuer, can I understand accounting issues that I am expected to see about my company or a company in my field. If i work in insurance, would I be financially literate wrt any insurance company. This is context driven.
 - You don’t need to be an accountant to be financially literate. But you need some accounting experience.
 - It is not necessary to have a comprehensive knowledge of GAAP or GAAS.
 - You can appoint someone who is not financially literate so long as they become financially literate within a reasonable amount of time (taking a course). Doing this does give rise to additional disclosure requirements.
 - Requirement to disclose the basis for which the company thinks they are financially literate. Why = their experience (took courses and did their own accounting for 10 years for their business).

(b)--Role of the Audit Committee

- The audit committee must have a written charter that sets out its mandate and responsibilities.
 - The following bullets should be set out in its charter
- The Corporation must require its external auditor to report directly to the audit committee.
 - Auditor does not report to President, they report directly to audit committee.

- The audit committee must be directly responsible for overseeing the work of the external auditor.
- The audit committee must recommend to the BOD the external auditor to be nominated and the compensation of such auditor.
- The audit committee must pre-approve all non-audit services to be provided by the external auditor.
 - Non-audit services means any services that auditor does that is not directly related to the audit. Ex. Reviewing interim statements, providing tax advice, consulting wrt your internal controls.
- The audit committee must review the financial statements, Management Discussion and Analysis as well as related press releases before they are disclosed to the public.
 - They will make a recommendation stating if they think the BOD should approve this.
- The audit committee must be satisfied that there are adequate procedures in place for the review of the Corporation's public disclosure of financial information, and must also periodically assess the adequacy of those procedures. (this will include internal controls for financial reporting).
- The audit committee must establish procedures for complaints received by the Corporation regarding accounting and related matters and also for dealing with confidential, anonymous submissions by employees regarding accounting related matters (whistle blower procedures).
 - Whistle blower procedures: can safely and anonymously state these things to a 3rd party.
- The audit committee must review and approve the Corporation's policies regarding hiring former employees of the auditor and partners of present and former external auditors.
 - Inherent conflict: they are doing the audit and then are offered a job (is this compensation to keep them quiet)
- The audit committee must have the authority to engage and pay independent counsel (ex. legal) to advise them and other advisors and also to communicate directly with internal and external auditors.

(c) Disclosure Requirements about the Committee that arise under 52-110

- s.5.1: required disclosure → every issuer must include in its AIF the disclosure required by 52-110F1.
- **The Annual Information Form (AIF) must include (so on an annual basis):**
 - (i) text of the audit committee charter
 - (ii) names of member so audit committee and whether they are independent and financially literate
 - (iii) disclose for each member their relevant education and experience
 - Ex. Joe is financially literate cuz he took accounting courses in University, does his own company's financial statements.
 - (iv) disclosure of any reliance on exemptions under the NI
 - Appointed someone not financially literate and sent him off to a course.
 - (v) disclosure of any committee recommendations the Board has not adopted
 - (vi) disclosure of any policies for pre-approval of non-audit services
 - Anything under 10K you have pre-approval.
 - (vii) break down of fees paid to external auditors (audit fees, audit related fees, tax fees, other)
 - Hired them to analyze a possible take over company.
- Information Circular (for AGM) must contain cross reference to information in AIF.
- s. 5.2 – Management information circular:
 - If management solicits proxies from the security holders of the issuer for the purpose of electing the BOD's, the issuer must include in MIC a cross-reference to the sections in the issuer's AIF that contains the information required by 5.1

(d) Venture Issuers get some breaks

- **Venture issuers are exempt** from requirements for composition of audit committee (must still comply with corporate requirements, ex. ABCA, (3 directors on audit committee, 2 must not be officers or EE's)) and have modified disclosure requirements:
 - Thus, none of the members on the audit committee for a VI have to be independent or financially literate but still have to disclose their names and whether they are literate or independent.
- End of financial disclosure discussion.

- Chose a company, Emerald Bay Energy on SEDAR to look at their interim financial statements.
 - Balance sheet is a snap shot (one point in time): compares Sept 30 2009 to Dec 31 2008 (last years year end). Not September to September.
 - Other financial disclosure docs will do September to September. Some for the last 3 months (interim to interim).
 - Must include MD&A with interim financial statement. A discussion wrt interim financial statements.
 - Must include officers certificate with MD&A and interim financial statements.

(B)--Change in Year End

- This is a Financial related disclosure. A company may change its year end.
- Section 4.8 of NI 51-102 requires reporting issuer to file a notice of change in its financial year end with the SC. They are expecting us to file by year end, so we must tell them when our deadlines change.
- Notice must be filed by the **earlier** of the next financial statement filing deadline based on either the old financial year or the new financial year.
 - Ex. it is nov. 29, we must file a notice, we changed our period, here is what our new periods are going to be.
- Notice must state:
 1. That the reporting issuer has decided to change its year end.
 2. The reason for the change (ex. acquired a company and they had a different year end).
 3. The old financial year.
 4. The new financial year.
 5. The length and ending date of the interim and annual financial statements, including the comparative periods, during the **transition year** and the **new year**.
 - Our transition period we will have a 6 month year. And new year will start on such and such date.
 6. The filing deadlines for the financial statements during the transition year.
- Transition year:
 - "Transition year" – means the financial year of a RI in which the issuer changes its financial YE
 - s. 4.8(4) – Max length of transition year:
 - A transition year cannot exceed 15 months
 - Could be from 1 month up to 15 months
- Comparative Interim Statements
 - During Transition Year: Same as old financial year
 - Keep the same comparatives
 - During New Year: for the same calendar months in the previous year, or as close as possible
 - Reformat old statements to meet the new dates. Have to redo accounting to figure out what Nov to Feb would have looked like.
- Example:
 - Assume "today's" date is March 6th, 2006
 - A non-venture issuer had a YE on Oct 31st, and wants to change to Nov 31st
 - Oct 31st YE Q's:
 - Three month periods ending Jan 31st, Apr 30th, July 31st
 - Nov 31st YE Q's:
 - Feb 28th, May 30th, Aug 31st
 - Today's date is March 6th, and since the filing deadline for IFS for non-venture issuers is 45 days, the filing deadline for the period ending Jan 31st would be March 17th
 - However, we have decided to change our YE, and therefore, we must inform the ASC
 - Transition year – the year in which C changes its YE
 - Here, there are two possibilities: could use either Nov 31st, 2005 (1 month); or Nov 31st 2006 (13 months)
 - Since the filing deadline for the 1 month YE has passed (would have ended Nov 31st which would make the YE FS due on Feb 28th), we cannot use the 1 month period
 - So, we can only use Nov 31st, 2006 as the YE
 - Comparative statements:
 - During transition year, we use the same interim statement periods as we did in the old YE

- During the new year, we are only offset by 1 month, so we should be able to use the old FS (“as close as possible”)

(C)--Change of Auditor -- have a notice requirement if we change auditors

- Auditor is appointed by shareholders of company and terminated by shareholders by a vote. Company can't fire an auditor, if they want to make a change in the middle of the year, ask them to please resign.
- Imposes notice requirements when a company changes its external auditors or decides it wants to change its external auditors. When a co. changes auditors it has to file a notice.
- There are 2 ways to change auditors: (1) can ask them to resign [in which case board has authority to appoint another auditor to fill the vacancy until the next s/h meeting]; or (2) have s/hs replace auditors.

Section 4.11 of NI 51-102

When an auditor is terminated or resigns and when an auditor is appointed issuer must:

1. Within 10 days prepare a **change of auditor notice** and send to former (old ones) and/or successor (new ones coming in) auditor and request response to notice to be delivered within 20 days of change. This letter states whether they agree with info in the notice.
2. Within 30 days:
 - (a) have reporting package [Notice and response letter(s)] reviewed by Board of directors or audit committee;
 - (b) must file reporting package with securities commission;
 - (c) deliver copy of reporting package to former/successor auditor;
 - (d) **IF** there are any **reportable events**, issue a news release.
3. Include copy of reporting package with relevant information circular, with a summary of the package to the shareholders.
 - We don't want to appoint the old guys at the next meeting.

Change of Auditor Notice

1. Date of change.
2. Circumstances of change (e.g. resignation, removal; at request of issuer or own initiative).
3. Whether change was considered by audit committee or board of directors.
4. Whether audit reports for last two years contained any reservations.
 - Has there been a qualification or denial in the audit reports in the last 2 years. We don't give you a clear audit report cuz we couldn't look at inventory.
5. Whether there is a reportable event and, if so, a description.

What is a Reportable Event

- A “disagreement” between company and auditor: difference of opinion between issuer and auditors that did result or would have resulted, if unresolved, in a reservation in the audit report or qualified audit report or adverse communication or denial of assurance.
- “consultation”: advice provided by the successor (new guy) auditor respecting audit work or accounting principles.
 - Before i hired new guy, we consulted him how he will do the audit--advice about audit work or accounting principles--how will you treat us. Consultation does not include: hey do you want be our auditor.
- “unresolved issue”: a matter that could have a material impact on the financial statements or an auditors’ report that was not resolved prior to the termination/resignation.
 - If I am in fight with auditors, they don't want to do what we ask, so we fire them, so we have to describe what they don't want to do and file this.

(D)—Annual Information Form

- Every Issuer that is **not** a Venture Issuer must file an Annual Information Form, in accordance with Form 51-102F2, within 90 days of its financial year end (same as deadline for filing year end financial statements).
- This is a cross between a prospectus and an annual report. Talks about current management, material K’s, etc.

- Venture issuers **don't** have to do this. They can if they want—if they do so, they can get in POP system (be able to file short form prospectus exemptions). POP requires a AIF. Filing an AIF does not automatically get you into POP system, you still have to opt in too.
- Non-venture issuer must file but if they want in POP then they have to opt in too.
- Oil and gas businesses--51-101:
 - Obligation to file an annual report of their oil and gas reserves (proven, probable and producible). Disclose what value is and volumes produced over past 12 months.
 - How do you determine value of reserves:
 - constant dollar pricing : take today's oil costs and drilling costs and assume they don't change
 - Escalating pricing: make assumptions about price of oil, inflation and drilling costs in the future. Take these assumptions into calculation in determining value.

The Following Continuous Disclosure Requirements are **Special Occurrences**--these disclosures are triggered by ad hoc circumstances (must file the following when the special circumstances occur).

(E)--Material Change Report--Part 7 of 51-102

- **If a material change occurs, corp must provide disclosure.**
- **Material Change:** a change in the business, operations or capital of a corporation that would “**reasonably**” be expected to have a “**significant**” effect on the market price or value of its securities, **and includes a decision to implement a change.**
 - “reasonable” and “significant” are relative terms, and will vary from RI to RI. It is up to each RI to decide what is material in the context of its own affairs.
 - Market price or value: if a share is not trading or trading thinly there may not be a market price (nothing that accurately states value). This is irrelevant--if a change affects the value of the security it must be disclosed. Would we reasonably expect to have a significant effect on the value?
 - A material change includes a decision to implement a change even if it has not been put into effect yet.
 - In any transaction, there may be several events that happen over a transaction each of which may be a material change. Ex. Pubco wants to buy another business. Make decision to buy. This decision to buy is material. When you identify a target and begin negotiations--this could be material. When you sign a letter of intent--this may be material. Sign a formal K--this may be material. When the deal closes--this may be a material event.
 - Material change may be nothing that we did. Ex. Earthquake destroys our factories.

Upon the occurrence of a material change—s.7.1:

1. “**Immediately**” issue and file a news release.
 - Within 1 business day or same day that change occurs.
 - Where is news released: Stock exchange has recognized newswire services that you are required to use. Ex. Canada Newswire--ask them to send it to these people. Must be filed on SEDAR too.
 - It is possible to file a news release that is not a material change. Lots do this to be safe.
2. After RI issues news release must file a **material change report** (Form 51-102F3) within 10 days.
 - This should be more detailed than news release. File it on SEDAR
 - Issue news release, did trading volume increase or decrease after the release. If not, i'm not filing a material change report.

s.7.1(3) will allow us in some situations to keep material change confidential. There are two situations where a material change can be kept confidential:

Confidential Material Change

2 occasions when a company can keep a material change confidential:

1. **In the opinion of the issuer, arrived at in a reasonable manner, the required disclosure would be unduly detrimental to the interests of the issuer.**

- Question is whether disclosure is detrimental to the interests of the issuer, not whether the change/event is detrimental in itself. Fact that news itself is detrimental is not justification for keeping material change confidential. It is only where disclosure or timing of disclosure would be detrimental to the issuer that it can be kept confidential. Ex – mining co. has done exploration and found gold vein extending onto neighboring property. Announcing that material change would be detrimental to the co. b/c it would impair ability to increase land holdings.

2. **The material change is a decision by senior management to implement a change, who believe that board approval is probable and have no reason to believe that the information will be used to buy or sell securities** (no reason to believe that this info will be leaked--maintain the confidentiality).

- Signed a K to go buy a business subject to BOD approval. Don't want to announce yet in case BOD doesn't ratify it.
- The confidential material change report must still be filed within 10 days of material change, but we file it on a confidential basis (don't file it on SEDAR, mail it in) and confidentiality must be renewed every 10 days (send a letter stating that the report is still confidential) for so long as you keep it confidential. Must disclose basis for why this is being filed confidentiality.
- Once confidentiality is gone, must file news release and public material change report.
- If info is still confidential but you become aware of a leak then you must issue a news release.

(F)--Business Acquisition Report (BAR)

- **This may occur in conjunction with a material change.**
- Within 75 days of completing a “**significant acquisition**” an issuer must file a Business Acquisition Report (Form 51-102F5), including audited (and interim) financial statements and pro forma financial statements. If target’s last year end is 45 days or less before acquisition date, filing deadline extended to 90 days (non-venture issuer or 120 days (venture issuer) after date of acquisition.
- “**Significant acquisition**” –**non-venture issuer test: 20% threshold under any of the Asset, Investment or Income tests (there are 3 tests for determining if something is a significant acquisition):**
 - **Asset test:** if assets that we bought are worth more than 20% of our value then it significant. If we have 10 million in assets, asset is worth 2 million then this is significant acquisition.
 - **Investment test:** what we invest in the target +what we are buying for. Pay 1 million and invest 2 million. We have 10 million in assets. This is sig
 - **Income test:** net income of target vs. net income of our company. If we made a million and they made 200K then this is sig. Note – s.8.7 looks at absolute value or magnitude of that income which means if I suffer a loss I do not treat that as a negative number I treat that as a positive number. If I suffer a loss on \$1,000,000, that is treated as \$1,000,000 of income
- 20% sig factor--must do years worth of audits
- 40% sig factor--must do 2 years worth of audits
- What goes in a BAR: provides basic information about the transaction, name of business, date that you acquired, how much did you pay, etc. Must include financial statements too-->audited financial statements for the target. Must include pro-forma statements (takes target and mine and adds them together--if we owned target from beginning of year this is what would our value look like. May need to include interim financial statements (most recent quarter) with pro forma interim statements as well.
- **If you are a VI, not sig unless it passes a 40% sig test. And income test cannot be applied against VI.** VI only required to give 1 year info of target company.
- s.8.10 provides a bit of an exemption by SC for oil and gas business in AB. If asset you have acquired is an oil and gas co. and there is not in existence a set of financial statements you do not need to include financial statements, just include operating statements and those need to be audited.
- This applies to assets, companies, business-->must do BAR.

(G)--Proxy Solicitations and Information Circular--51-102

- **What is a proxy: an instrument in writing giving someone else the authority to vote your shares for you.** Co calls meeting of shareholders, most s/h won't show up, so you give someone authority to vote for you at the s/h meeting. They don't have any other authority--they are required to vote in this manner.
- Issuer must send out a **form of proxy** at the same time it calls a meeting of the holders of voting securities. If you can't attend you can appoint someone to vote your shares for you.
- What does a proxy do? A "proxy" discloses important information:
 - It lists the issues to be discussed at an AGM
 - Serves as a ballot for elections to the BOD
 - Lists the largest shareholders of a company's stock
 - Provides detailed information about executive compensation
- **S.9.1(2): When any person (whether the management or otherwise) solicits proxies, they must send an information circular (Form 51-102F5) to each person whose proxy is solicited.**
 - Any person that solicits proxies (shareholder vote) must send out an information circular.
 - Defn of solicit: sending a form of proxy is a solicitation of proxy. When a co calls a s/h meeting it is required to send an instrument of proxy, thus it must always send out an information circular.
 - If company calls meeting the circular is called a "management information circular". Company must send it to everyone.
 - If someone else calls meeting then it is called a "dissident information circular". Will only send it to people they are soliciting--they don't have to solicit everyone.
 - S.9.2(2) of 51-102: if not management of company and you are soliciting from less than 15 people I do not have to send out an information circular under this instrument under securities regulations. These rules do not apply to a solicitation if the total number of SHs whose proxies are solicited is not more than 15.
 - However, an AB corp is also subject to ABCA and it has its own rules wrt proxy solicitations.
 - S.150 ABCA: requirement for company or dissident to send out an information circular if they are soliciting proxies applies if co has more than 15 shareholders. You don't have to be a RI, if you have more than 15 SH you have to comply with securities regulation. However, if a corp has less than 15 SH's total that are entitled to vote then they don't have to send out an information circular under the ABCA.
 - So if co has 100 s/h and you are soliciting 2 s/h, and you don't file an info circular then you haven't broken securities regulations but you have breached ABCA.
- Information Circular to include disclosure of compensation of named executive officers (NEO) and directors in accordance with Form 51-102F6.
 - NEO = CEO, CFO and next top 3 highest paid executives provided their annual compensation (salary, bonus, stock options) was at least 150K. If CEO and CFO make less than a150K it still must be disclosed. If VP makes 100K that does not get disclosed. Must disclose every element of the compensation.
 - Also requires info about officers, directors, large shareholders, issues to be discussed at the meeting, related party transactions
- **NI 58-101 will require disclosure of Corporate Governance practices in the information circular.**
 - National Policy 58-201 sets out recommended best practices for corporate governance.
 - Various committees a board should have
 - Board should be made up with some independent outside directors
 - Written mandates for board
 - Codes of ethics and conduct
 - This is a policy, a policy is not a rule and not binding. It provides us with guidance. No one is required to follow them. Most smaller companies don't follow many of these 58-201 guidelines. Not practical for all companies to adopt
 - NI 58-101 is a mandatory rule. Company must provide information circular saying how they are going to deal with corporate governance and has to disclose if they are going to follow recommended corporate governance guidelines; and if they do follow them, describe how.
 - If you have written code of business conduct it must be filed on SEDAR.

(H)--Distribution of Shareholder Material NI 54-101--how you call a shareholder meeting (see charts)

- Need to have meetings:
 - ABCA requires that C's have an AGM 18 months following incorporation, and not later than every 15 months thereafter
 - At the meetings, the directors are elected, financial statements are presented, auditors are appointed
 - The C needs to have a way to get in touch with its SH's to inform them about the meetings
- **Registered SH's:**
 - Very few SH's are registered SH's – those SH's whose name actually appears on the share certificate. The company is required to maintain a registry which compiles a list of all of its registered SH's
 - Ex. Mom and Pop set up a company. Corp issues 50 shares to Mom, Pop and Uncle Bob (they are issued a share certificate stating their name and how many shares they own)
 - However, if every SH were to hold a share certificate, it would complicate the trading process as the certificate would have to be turned over on every trade (SH would have to go to bank, sign it and transfer it)
 - Therefore, most SH's beneficially own their shares through their brokers
- **Beneficial SH's:**
 - Mom and Pop company wants to go public now. Broker finds people to buy. At closing of offering, treasury direction (instruction to transfer agent) "issue 5 million shares to broker", then transfer agent hands broker the certificate for 5 million shares. Broker has 500 clients lined up. Broker holds onto the shares for his clients. So this certificate does not get broken down—broker will hold onto this share for 500 different people, but it has his name on the certificate.
 - When one of those people wants to sell their shares to someone else, then the broker must take certificate and deposit with a depository. In Canada it is called CDS & Co. (Canadian Depository for Securities), they will hold the certificate for 5 million shares. They hold it for the broker. They represent the brokerage firms. The brokers don't own it either, they hold it for clients. So beneficial holders are the real owners of the company. Rather than the brokers transferring certificates on each trade, the CDS / transfer agents do up a list at the end of each day and then determine what the net transfer is to be. Broker delivers certificates to depository; depository keeps a list of all the brokers that it is holding the shares for.
 - **Beneficial shareholders don't have a certificate, CDS holds certificate for broker who holds it for beneficial shareholders.**
 - When it comes time to call a meeting, a corp can get a hold of its registered SH's (send them proxy and information circular). But a company's mailing list of beneficial shareholders is not very informative—it just states the broker's name. **The SC made up 54-101 to help company communicate with its shareholders even though company has no idea who they are.** How do we reach these people? Beneficial s/h, don't have share in their name, share is in name of broker, don't know who they are, **there are 2 categories of beneficial shareholder: OBO and NOBO.**
- **OBO – Objecting Beneficial Owner:** Objects to disclosure of ownership information about the beneficial owner. He objects to having his personal info provided to a company. Co can't get any info about OBO.
- **NOBO – Non-objecting Beneficial Owner:** Does not object to disclosure of ownership information about the beneficial owner.
 - He consented to having his personal info provided to companies in which he invests. When you open an acct with a brokerage firm, firm asks person this.
- So we have registered shareholders (we know who they are, they have certificates in their names) and then we have beneficial owners (OBO or NOBOs)

Distribution of shareholder meeting--how do we call a meeting—corp must set 2 dates:

- **Meeting Date:** date of the meeting.
- **Record Date:** date which you produce shareholder list (ones authorized to vote at meeting). This will change every single day as people buy and sell. Freeze this list as of this date. Whoever is on the list at this date gets to vote = record date.

Set of Rules wrt Timing of Calling a SH Meeting

- (1): Record Date: it must be at least 30 days and no more than 60 days before the meeting date [note: ABCA limit is no more than 50 days before meeting date].
 - May 15 shareholder meeting. April 15th could be record date (I will produce shareholder list for my voting list). On this list, it will show registered shareholders and beneficial owners (Broker A will produce list, Broker B will produce list of their clients on that record date, etc.). Beneficial owner will be broken into OBOs and NOBOs.
- (2): Must give initial notice at least 25 days to regulators, exchange, and depositories to get their crap ready for the record date.
 - Mar 15 give notice to regulators-->April 15 record date-->May 15 shareholder meeting. **So this process takes a minimum of 55 days (30 + 25) to call a shareholder meeting.** ABCA says 21 day notice must be given for a shareholder meeting.
 - We tell CDS record date and meeting date. Depository will give me a list of all brokerage firms that hold shares in my company (`a list of the participants`).
- (3): At least 20 days before the record date the Corporation then sends the participants (these brokerage firms) a request for beneficial ownership information [OBO's vs. NOBO's]
 - For OBOs, how many clients do you have holding shares in us, then corps sends them that many info circulars and proxies, and the broker will send them out to the clients.
 - For NOBOs there are 2 options:
 - Broker has list of NOBOs, just tell me how many there are then I will send you that many info circulars and you mail them out for us.
 - Or we can ask for a list of the NOBOs with names and number of shares. I have to treat this like just like a registered shareholder and I will mail the info out to them.
 - To get a NOBO must give an undertaking, I will only use this list for authorized corp purposes (takeover bid, soliciting bids). Have to pay brokerage firm for NOBO list.
 - OBO = broker always deal with them. For NOBO can treat them like an OBO or treat them like registered shareholders.
- (4): the ABCA requires a newspaper ad to be published at least 7 days before the record date; this will be done automatically by CDS when proper notice is given under NI 54-101.
 - When pubco sets a record date it must do this. Privco's do not have to file this newspaper ad.
- (5): The Corporation then sends the information circular to shareholders with the form of proxy:
 - (a) **If sent indirectly** (thru the brokers) to OBOs and maybe NOBOs it must be sent to the intermediary (broker) at least 4 business days before the 21st day before the meeting date;
 - This bulk delivery to brokerage firms (Broker A has 5 OBOs, Broker B has 15 OBOs). **21 + 4 business days** before the meeting date (so this is not 25 days). So this gives brokers 4 business days to send out info circular before ABCA requirement of 21 day notice is up.
 - Broadbridge does mailings for every brokerage firms in Canada, so just send all the circulars here (not 5 to A and 15 to B).
 - (b) **If sent directly** to NOBO's (treating them like registered shareholders), it must be sent at least 21 days before the meeting date just as is required for registered shareholders;
 - (c) Under the ABCA must send to registered shareholders **at least 21 days** before the meeting.
- See graph.
- (7): Voting is Affected
 - Registered shareholders can show up to vote.
 - How do beneficial shareholders vote? Thru proxy. If they walk into meeting, they won't be on the list-->so they can't vote at meeting, must do it thru proxy.
 - OBO's and NOBO's treated as OBO's:
 - These SH's s send their voting instructions to their brokers who then sends voting instructions to the C. Then, CDS compiles and sends an omnibus proxy to the C. This proxy states we are holding 5 million shares (Broker A has 1 million), we authorize those brokerage firms to vote those shares.
 - Special appointments
 - May have a scenario where a SH wants to attend the meeting

- The broker then gives a proxy authorizing this special appointment, such that when the SH comes to the meeting, he will be able to vote
- SH's can vote for, against or abstain (withhold) their vote for the management's proposals:
 - Wrt election of directors and appointment of auditors: the only 2 voting options are for and abstain. Logic behind this is a Co. must have a BOD.
 - If I am at meeting and I want to vote against the D, you must nominate someone else

Restricted Share Disclosure—51-102 Part 10

- A C may issue a class of shares with more powers attached to it than another class of shares. The information on the rights of these unique share classes needs to be described in the information circulars [disclosure] and circulated not only to those SHs but also the inferior classes of SHs [dissemination].
- **A restricted share is a share whose voting rights are restricted in 1 of 2 ways:** (1) Share itself may have restrictions on voting rights; (2) share could be restricted b/c there is another class of shares that has superior voting rights or veto provisions. If some other shares have better voting rights than yours is a restricted share.

2 sets of rules relating to restricted shares:

(1)-Description

- Securities that have restricted voting rights must be appropriately referred to as restricted securities.
- Securities cannot be referred to as “common”, “preferred” or “preference” securities unless they are in fact common or preference shares, as the case may be.
- **“common share”** – an equity security carrying voting rights that are not less than the voting rights attached to any other outstanding securities of the issuer.
- **“preference share”** a security to which is attached a preference or right over the securities of another class of equity securities of the issuer, but excludes an equity security.
- Cannot call them preferred shares unless they have some form of preference – they must have a preference over the securities of another class. Ex- a right to get a dividend in priority to other shares.
- Must properly describe the shares so if I buy common shares I know what I am getting.

(2)-Dissemination

- If an issuer sends a document to all holders of any class of equity securities it must also send it the holders of restricted securities at the same time.
- If I send something to common shares, must send same doc to restricted s/h. So just cuz they are non-voting they still get to know what is going on in the company.

Other Filing Requirements (catch all category)(these are filed on SEDAR)

- (a) Any disclosure material that is sent to more than 50% of its shareholders must also be filed with the Securities Commission, even if the document is not otherwise required to be filed. To be filed on the same day, or as soon thereafter as practicable, that the material is sent to the shareholders [s. 11.1(1)(a)].
- (b) Any documents filed with the SEC [s. 11.1(1)(b)].
 - SEC is US stuff. If I am RI in Canada and I file something with SEC must file what I did with SC.
- (c) An issuer is required to file a notice promptly after its status changes either to or from that of a Venture Issuer [s. 11.2].
- (d) After shareholder meetings at which a matter is submitted to a vote the issuer, other than a Venture Issuer, is required to file a report describing the matter and the result of the vote [s.11.3].
 - I am not a venture issuer.
- (e) Any news release containing financial results is required to be filed [s. 11.4].
 - Most companies file every news release on SEDAR.
- (f) Unless previously filed, a company is required to file through SEDAR copies of its Articles of Incorporation and By-laws, and any voting trust agreement, rights plan or any other agreement materially affecting the rights or obligations of shareholders [s. 12.1].
 - If one of these docs is created or amended then we have to file this.
- (g) Unless previously filed, issuers will be required to file copies of all material contracts in effect (contracts entered into before January 1, 2002 need not be filed). Where a material contract contains provisions the disclosure of which

would be seriously prejudicial to the company's interests or would violate a confidentiality provision, then the contract may be filed with those particular provisions omitted [s. 12.2].

- A material K may contain things that should be kept confidential.

The deadline to file the articles, etc. and material contracts (that affects s/h rights) is the earlier of:

- (i) If the document relates to a material change, then the time that the applicable material change report is filed (10 days); or
- (ii) The time that the next Annual Information Form is filed or, if no Annual Information Form is required, within 120 days of the next financial year end.

(I)--Sanctions and Liability for Failing to File

- **If you are a RI** and you don't comply with continuous disclosure requirements, what are the consequences for non-compliance? **Non-compliance = failing to file a document that is required to be filed under the Act on time or filing a document that contains a misrepresentation (does not comply with rules)→non-compliance is an offence under s.194 of the Act.**
- **Penalty for non-compliance:** SC has authority to impose penal action and administrative sanctions – fines, costs, issue cease trade order. **If co. has not filed financial statements in time a cease trade order is usually imposed** on the basis that market does not have enough info for investors to make a decision.
- **Cease Trade Orders**
 - CTO = all securities of XYZ Ltd. are prohibited from being traded.
 - For any offence under Act or SC considers it in public interest to do so--they can issue a CTO.
 - Must provide person a hearing for permanent CTO.
 - s.33 SA: provides staff of SC with authority to grant an interim CTO without advance notice to company and without holding a hearing. They can immediately issue an interim CTO, but it can last for up to 15 days.
 - Ex. Fails to file its MD&A on time. AB SC usually sends fax to company saying you are late, what is going on. There is a risk though that if you are late one day SC could issue an interim CTO.
 - Typically a panel schedules a hearing every 2 weeks for company's subject to a interim CTO. At this hearing they will discuss whether they will order a permanent CTO. If you don't file required financial docs (MD&A) by the time the panel sits then they can just order the permanent order. If you file docs before hearing date, then the hearing date will not go forward and the interim cease trade order will lapse after the 15 days.
 - If permanent order is issued (indefinite duration) ; it continues until you apply to have it revoked. Before you apply you have to remedy the defect.
 - If you are late with your financial statements ask for a Management CTO. Issued only against management of the company--only D's and O's are prohibited from trading. SH's are still able to buy and sell shares.
 - **SC: Factors to consider for granting a MCTO --National Policy 12-203**
 - Delinquent filings will be completed within a reasonable time (2 months).
 - Issuer is either generating revenue or actively pursuing the development of its business. So it won't grant a management cease trade order for an inactive business
 - Issuer will have financial and human resources to address the default in a timely manner. Ex. Have money to pay accountants to get it done.
 - Securities must be listed and actively traded on a Canadian stock exchange. Ex. A 1000 shares once every 3 weeks is not active. So a thinly traded company won't get a MCTO.
 - Must not be in default with any other filing requirements except those related to financial statements. Finance statements that are related: officer certificates, MD&A
 - If MCTO is issued, company must release a "default notice" in a news release on SEDAR. Set out details of the default (statements will be completed by X). And must issue an update status report every 2 weeks to SC. If you don't do this, MCTO becomes a CTO.

(J)--Civil Liability for Continuous Disclosure (Secondary Market Disclosure)

- The above sanctions are regulatory consequences. There can also be civil consequences. In 2007, part 17.01 SA was released, civil liability for continuous disclosure (secondary market disclosure). When a prospectus contains a

misrepresentation s.203 imposes civil liability - gives investors rights of action against company and principals. **Up until 2007, there were no such rights available to investors when secondary market disclosure [documents filed under continuous disclosure requirements] contained a misrepresentation**

- **These civil consequences applies to “responsible issuers” → s.211.01 a responsible issuer is:**
 - **A Reporting issuer (in Alberta) or**
 - A co. that has filed and received receipt for a final prospectus, or a company whose stock are traded on stock exchange recognized in AB
 - **Includes company’s who have a real and substantial connection to AB and has publicly traded securities**
 - Where is corp incorporated, does it have a head or branch office in AB, where do its D and O reside, do many of its SH reside here

17.01 (civil liability for continuous disclosure) does not apply to as per s.211.02:

1. Securities purchased under a prospectus,
2. Securities purchased under a prospectus exemption,
3. Securities acquired due to a transaction under a take-over bid or issuer bid.

Basically it will not apply to issuance of shares from treasury; **rather, it will apply to secondary transactions in the market (open market transactions). It applies to both purchases and sales of securities.**

Liability applies to 3 types of misrepresentations:

1. liable if there has been a misrepresentation in a “document”.

- **S.211.1(c) defn of document:** A written communication (including in electronic form):
 - that is required to be filed with the Commission, or (AIF, financial statements), or
 - that is not required to be filed with the Commission but it is in fact:
 - filed with the Commission,
 - filed with a government, government agency or stock exchange, or
 - the content of which would reasonably be expected to affect the market price of value of the company’s securities.
 - Ex. Published a newspaper ad promoting company's shares
- Creates a subset of documents called “core documents”. These are the “core” disclosure documents; we designate them separately b/c we attach liability to them separately. Core documents includes: (i) Prospectus (if you buy shares thru prospectus you can’t use these civil remedies, must use.. . But this is a pubco, and if there is secondary trading, and prospectus is on SEDAR, then this may be info that I used to buy shares → then there can be civil liability); (ii) Take-over bid circular; (iii) Issuer bid circular (iv); Directors’ circular (issued in connection with a takeover bid); (v) Rights offering circular; (vi) Information circular for SH meeting; (vii) MD&A; (viii) AIF; (ix) Financial statements; and (x) Material change report

2.): A misrepresentation contained in a “public oral statement”.

- **TEST:** An oral statement made in circumstances that a reasonable person would believe that information contained in the statement will become generally disclosed.
 - Stand in hallway and whisper statement, not expect this to be disclosed
 - Stand up at SH meeting and I make a statement i can accept that will be public or at press conference or interviewed on TV. If this contains a misrep there could be liability

3.): A failure to make timely disclosure of material changes.

- if you have failed to file financial statements w/in required deadline or failed to file material change within required dealing that failure will give rise to liability

Liability for all 3 areas will apply to documents or statements made by the issuer itself or by a person with actual, implied or apparent authority to act on behalf of the issuer.

- Some company may have not made the statement, but say VP says something to newspaper reporter that person may be viewed as having apparent authority to act on behalf of corp and his statements can attract liability for the corp.
- Should have policies about who is authorized to make statements on behalf of the corp to protect the corp.

Liability can also attach to statements made by an “influential person” or someone with actual, implied or apparent authority to act on behalf of the influential person. Who is an Influential Person (s.211(f)):

- A control person (20% shareholder)
- a promoter (a person who founded the company)
- an insider that is not a director or officer of the responsible issuer (10% shareholder)
- where the issuer is an investment fund, then the investment fund manager.
 - Basically, these people are not on board, not EE's, just shareholders or used to be in high positions, but because of their position statements that they make are given weight by the market place. Statements that can attract liability.

If there is a misrep where does liability lie (who will be liable for the misrep):

- 1. Liability for statements made by the issuer or persons with actual, implied or apparent authority to act on behalf of the issuer (211.03(1)):**
 - The responsible issuer--company itself will be liable for this statement or doc.
 - Each director for a written doc. (Directors will only be liable for oral statements if they authorized, permitted or acquiesced in the making of the oral statement).
 - Each officer that authorized, permitted or acquiesced in the making of the disclosure. Whether written or oral. O not automatically liable unless they participated.
 - Each influential person, and each director and officer of the influential person who knowingly influenced (i) the issuer (or person) to make the statement, or (ii) a director or officer to authorize, permit or acquiesce in the making of the statement.
 - Each expert, where the misrepresentation is also contained in the expert’s report, statement or opinion, the disclosure summarizes or quotes from the report, **and** the expert released the statement himself or gave written consent to the company to make use of the report.
- 2. Liability for disclosure made by an influential person or on behalf of the influential person (this is Joe Blow who owns more than 20% of the shares)—s.211.03(3):**
 - the responsible issuer (company) is liable if a director or officer of the issuer authorized, permitted or acquiesced in the making of the disclosure (It endorsed the statement then they are liable).
 - the person that made the disclosure.
 - each director and officer of the issuer that authorized, permitted or acquiesced in the making of the disclosure.
 - Yeah that is a good statement to make, go for it. I make myself liable and corp liable here.
 - the influential person.
 - each director and officer of the influential person that authorized, permitted or acquiesced in the making of the disclosure.
 - each expert, under the circumstances described above.
- 3. Liability for failure to make timely disclosure of a material change—s.211.03(4):**
 - The responsible issuer has liability.
 - Each director and officer of the issuer that authorized, permitted or acquiesced in the failure to make timely disclosure.
 - Not every D and O is liable here. Only liable if they authorized it.
 - Each influential person, and each director and officer or the influential person who knowingly influenced:
 - The issuer (or person acting on its behalf) to fail to make timely disclosure, or
 - A director or officer to authorize, permit or acquiesce in the failure to make timely disclosure.
- 4. S.211.03(7):** In an action under subsection (2) or (3), if the person who made the public oral statement had apparent authority, but not implied or actual authority, to speak on behalf of the issuer, no other person is liable with respect to any of the responsible issuer’s

securities that were acquired or disposed of before that other person became, or should reasonably have become, aware of the misrepresentation.

If the misrep is contained in an oral statement and that person had apparent authority to act on behalf of co and did not have implied or actual authority then the only people liable will be him and anyone who authorized the statement. Once you became aware of the problem, you must fix it or you will have liability yourself.

Liability limits (what you will be liable for):

- **Your limit is capped, doesn't matter how many people sue in how many jurisdictions, the total amount that you will be liable for will be capped.**
- One misrep may appear in different docs (Mis rep in news release and in material change report. Same misrep in 2 different docs). If same misrep we will treat it as one liability trigger. It is not 2 misreps, just 1 misrep.
 - S.211.03(6): (a) multiple misrepresentations having common subject-matter or content may, in the discretion of the court, be treated as a single misrepresentation, and (b) multiple instances of failure to make timely disclosure of a material change or material changes concerning common subject-matter may, in the discretion of the court, be treated as a single failure to make timely disclosure.

What are the limits—s.211.01(h):

- An individual (like a D or O other than an expert): the most you will be liable for is the greater of \$25,000 or 50% of the aggregate of their compensation from the issuer (or the influential person, as the case may be) in the past 12 months prior to the misrepresentation, or failure to make timely disclosure
- The responsible issuer (the company) or an influential person that is a company: the greater of \$1 million or 5% of its market capitalization (total market value of your outstanding shares--10 million shares outstanding and trading at \$1, that is \$10 million, so 5% of 10 million is 500K).
- An expert: the greater of \$1 million or the total revenue (100% of your compensation) received from the company in the previous 12 months.

How do we calculate these damages—s.211.05

- If there has been a misrep and I bought and sold shares, and lost money cuz of misrep, corp will compensate me for this loss.
- **Rule: damages are equal to the difference between the value at time misrep was made (when I bought) as compared to what the value of the shares is after the misrepresentation is corrected.**
 - Ex. Co issues news release about a great deal. Stock shoots up to \$10 a share. I buy at \$10. but news release contained mis rep. Co issues a correction, here are the real numbers. Stock drops to \$4 a share. I sell on this day. The value I lost is \$6 a share if I sold at this day→that is the measure of my damages.
- **Rule: 10 days after correction is issued** (I bought the shares at high price (\$10) and sell shares at low price after the bad news (\$4)).
 - If I sold shares within 10 days of correction coming out (not 10 days after misrepresentation was made – within 10 days of correction that first good news was false) the measure of damages is difference b/n two prices: what I actually bought them at and what I actually sold them at.
 - Ex. Buy at \$10 and I sold within that 10 day period (right after the correction came out) at \$6 a share. My loss is \$4 a share. This is what I would claim in damages.
 - If I sold the shares after more than 10 days I am entitled to damages that are the lesser of the difference b/n my actual purchase price (when I bought) and sale price or the difference b/n purchase price and trading price during 10 trading days after correction. Ex – correction comes out, what is the trading price for next 10 days? This approach recognizes that within 10 days market should have corrected itself to reflect true value based upon current information. Amount of my damages is lesser of two amounts.
 - I sold at \$3 a share, if at the end of 10 days they were trading at \$4 a share, that puts a limit on how much damages i can ask for. Or if i sold after 10 days for \$5, then my damage is rooted to the \$5.
- Your damages: takes into account commissions that you paid to buy and to sell. \$200 in commission on these trades. Get compensated for that too.

- Also take into account any hedging transactions that you engaged in which may have increased or decreased my loss
 - Increased my loss; put option.
 - Decrease my liability: cuz i bought a put option for someone has to buy at \$6.
- If i sold shares while there was uncorrected error and i suffered a loss, same principles apply.

Defences to Liability

- **Not liable for damages where defendant can prove that the loss is not attributable to the misrep** (burden on defendant). P's loss is attributable to factors other than misrep then I won't be responsible for their losses.
 - Loss was not caused by misrep, caused by market factors instead.
- When a CT is assessing damages and liability they will look at each DF. CT is required to determine each DF's responsibility and the liability of each DF will be based upon their degree of responsibility.
 - Pres is 50% liable for misrep, the other 5 D's are liable 10% each.
 - Liability is not joint and several. Only liable for that portion that is assessed to them. Except if the court determines that one of the D's knowingly authorized the misrep then that D will be wholly liable for the damages and liability will be joint and several. They will be entitled to contribution from other D's.
 - **If i knowingly authorized and participated in misrep then liability limits do not apply. Have maximum exposure.** Burden is on Plaintiff to prove this.

Defences to Liability—s.211.04

1. For a non-core document or an oral statement, the defendant (other than experts) will not be liable unless the **plaintiff** can prove (burden on the plaintiff) that—s.211.04(1):
 - a. they knew the statement contained the misrepresentation,
 - b. they deliberately avoided acquiring knowledge that the statement contained a misrepresentation (wilful blindness), or
 - c. the fact that the statement contained a misrepresentation was through the action, failure to act, or gross negligence of the defendant
 - Defence will try and demonstrate that I didn't know or wilful blindness, etc.
2. If the defendant can prove that the plaintiff knew that the statement contained a misrepresentation or knew of the undisclosed material change then they are not liable. (Rebutting the presumption of reliance).
3. Due diligence defence—s.211.04(6): If The defendant can prove that they conducted a **reasonable investigation and had no reasonable grounds** for believing that the statement contained a misrepresentation, or that the failure to make timely disclosure would occur (due diligence) then no liability.
 - 211.04(7): when considering if there has been a reasonable investigation, the court **shall** consider all relevant circumstances, including these:
 - The nature of the issuer
 - Type of business, size of company, size of its operations, number of directors
 - The knowledge, experience and function of the person
 - (individual D we are dealing with and what is their function in company. Was this a farmer who was sitting on a board as an outside director with no business experience
 - The office held (if applicable),
 - Are they the president or just a lower officer and their area of responsibility.
 - If they are a director, the presence or absence of another relationship with the issuer,
 - Are you just D or are you also on the audit committee
 - The existence and nature of any disclosure controls,
 - Disclosure controls on procedures and what are they like
 - The reasonableness of the person's reliance on the issuer's disclosure controls and its officers and employees,

- If you have an extensive set of controls that are well documented and have been proven in past then you can say I just relied on disclosure controls (this was vetted so I relied on it) this is reasonable reliance.
 - The time period within which disclosure was legally required to be made [if there was a requirement to make disclosure very quickly, such as in a news release, there would be less time available to do a thorough investigation],
 - More time we have more onus we have to check our facts and get it right
 - The professional standards of the expert (if applicable),
 - The extent to which the person knew, or should have known, the content and dissemination medium of the statement,
 - Did we know it would be disseminated widely. Expectation of how it would be used.
 - The role and responsibility of the person in preparing the statement or ascertaining the facts in it, or in deciding not to disclose a material change.
 - Were you given job of writing news release. More responsibility you had to develop the statement then the harder it will be to prove reasonable due diligence.
 - There is no single standard of due diligence--it depends on the circumstances.
4. In the case of a material change kept confidential: For a claim based on the failure to disclose a material change [s. 211.04(8)], the defendant will not be liable if they prove that the issuer filed a confidential material change report, and that:
- (i) there was a reasonable basis for keeping the change confidential,
 - (ii) it was disclosed once that basis for confidentiality ceased to exist,
 - (iii) the issuer did not make a public statement that contained a misrepresentation due to the undisclosed material change, and
 - (iv) if the change became public through another source, the issuer promptly disclosed it.
 - If there was leak we let the public know right away.
5. Forward looking information: anything that talks about the future (statement of what we think will happen to company over the next 12 months). For an alleged misrepresentation in forward-looking information [S.211.04(9)] in a disclosure document, the defendant will not be liable if they can prove that:
1. The statement with the forward-looking information contained, proximate to the information (warning near forward looking statement):
 - (a) reasonable cautionary language (warning--safe harbour statement) indicating that the information is forward-looking and identifying material factors that could result in variation, and
 - (b) a statement of the material factors or assumptions used in drawing the conclusion in the forward-looking information, **and**
 2. The person had a reasonable basis for drawing the conclusion.
 - Proximate to disclosure (standard practice): at the beginning of the doc, there should be a cautionary statement, this MD&A contains forward looking info, such statements are identified by statements such as we expect, hope, etc., these statements could be affected by....factors that may materially effect our corporation.
 - If making an oral statement which contains forward looking statement, speaker must make cautionary statement indicating that additional info that material factors is contained in a doc that is readily available on SEDAR.
6. A defendant (other than the expert) will not be liable for the expertized portion of a statement if he/she did not know there was a misrepresentation in that part of the document, and the statement was a fair representation of the report [s.211.04(13)].
- We didn't know report was wrong and our quote was a fair rep of that report. If we can prove that we are not liable.

7. The expert will not be liable if they withdrew their consent **prior** to the statement being issued [s.211.04(14)].
 - Expert will be liable if they issued it themselves or consented to the statement.
8. Doc not required to be filed: A person will not be liable, other than for a document that is required to be filed with the Commission, if they prove that they did not know, and did not have reasonable grounds to believe, that the document would be released [s.211.04(15)].
 - CFO prepares analysis of potential takeover, this report was to go just to BOD, nobody told me that they would quote it in news release. I thought it was an internal document not for public dissemination.
9. A person will not be liable if they prove that the misrepresentation is contained in a document filed with the Commission by another company, which had not been corrected, that other document was described as the source for the misrepresentation, and the person did not know and had no reasonable grounds to believe that it contained a misrepresentation [s.211.04(16)].
 - Another pubco filed a doc with SC and we quoted this other doc (must describe that other doc as our source) and we did not know it contained a misrep we are off the hook.
10. A Defendant will not be liable [s. 211.04(17)] if they can demonstrate that the disclosure was made without their knowledge or consent **and** that upon discovering a misrepresentation they provided prompt notice to the Board of Directors, and if the Board does not act within two business days the person must provide prompt written notice to the Alberta Securities Commission, unless prohibited from doing so by law or by professional confidentiality rules (this last statement protects lawyers--can't notify SC due to professional code).
 - This D will not be liable for this misrep
 - If BOD does not act and my code says i can't tell SC due to code, I can't participate in any future misreps then you can't continue to act for them. Lawyer cannot make a noisy withdrawal here. Do it quietly without people noticing.

Procedural Requirements or Protections

- A civil liability action cannot be commenced without the leave of the court (s. 211.08(1)).
- 211.08(2): Court will grant it if brought in good faith and that there is a reasonable possibility that it will succeed.
- Once leave has been granted the plaintiff is required to issue a news release to announce that fact (s.211.09).
- Once an action has been commenced, it cannot be discontinued, settled, or abandoned, without the approval of the court (s. 211.091).
- Notwithstanding the *Court of Queen's Bench Act* and the *Class Proceedings Act*, the successful party in the action is entitled to costs (s. 211.092).
 - Typical class action law suits, Plaintiff is not responsible for costs if they lose. So don't bring this action unless you are sure. You lose, you have to pay costs.
- The SC has the authority to intervene in any such action or leave application, and they are to be sent a copy of the leave application and supporting affidavits (s. 211.08(5) and s. 211.093).
- **Limitation period: 211.095** No action shall be commenced under section 211.03,
 - (a) in the case of misrepresentation, later than the earlier of **(action must be brought within 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 211.03 or under comparable legislation in the other provinces or territories in Canada in respect of the same misrepresentation;
 - Once this done, every one else in country must start their own law suit or join mine.

CH 5: INSIDER TRADING

- Only an issue if an insider trades info that is material and not generally disclosed to the public. There is nothing wrong with insiders selling their shares, it is only when insiders sell shares based on information that is unavailable to the public.

Reporting requirements:

- April 30 of this year, changes will come into effect. NI 55-104 is being created, right now a whole bunch of different rules in different instruments. There is not a lot of change. We will look at them as they are now.

Definitions:

Insider - Section 1(aa) of SA:

- (i) every director and officer of a reporting issuer,
- (ii) every person or company that owns and/or exercises control over, directly or indirectly, securities that represent more than 10% of the voting rights of the outstanding securities of the corporation,
- (iii) the corporation itself is an insider if it happens to hold any securities in itself that have not been cancelled, and
 - Generally corps are not allowed to hold shares in themselves.
- (iv) also includes every director and officer of every company that is itself an insider or subsidiary of the issuer.
 - RI owns subsid. X Co owns more than 10% of RI. So D and O of RI are insiders. X Co is an insider of the RI. D and O of X Co are insiders of the RI. D and O of subsid are insiders of the RI.

Deemed Insiders – Section 8

- If an issuer becomes an insider of a reporting issuer, the directors and officers of that issuer are deemed to have been insiders of the reporting issuer for the previous 6 months, or such shorter time that they were actually directors or officers of the reporting issuer.
 - If X Co buys more than 10% of shares of RI, the D and O of X Co are deemed to be insiders of the RI for the previous 6 months.
 - If X Co is pubco, then D and O of RI (target) is deemed to be an insider of X Co.
 - And required to report their trading activity for past 6 months.
- If a reporting issuer (holding company) becomes an insider of another reporting issuer (subsidiary) the directors and officers of the subsidiary are deemed to have been insiders of the holding company for the previous 6 months, or such shorter time that they were actually directors or officers of the subsidiary.

Officer – Section 1(II)

- (i)-chair, vice-chair, chief executive officer, chief operating officer, chief financial officer, president, vice-president, secretary, assistant secretary, treasurer, assistant treasury and general manager, or any other individual who performs functions similar to those normally performed by an individual holding that office (regardless of that their job title is), and
- (ii) Any person designated as an officer under a bylaw or similar authority of the issuer.

Special Relationship – Section 9 (who has liability for trading on insider information)

If you are in a special relationship you may not have reporting requirements, but you will have liability for trading on insider information. Section 9 tries to capture people who *may* have access to a company's material info

A person is in a special relationship with a reporting issuer if:

- (a) They are an insider, affiliate or associate of:
 - i. the reporting issuer,
 - ii. a person or company that is proposing to make a takeover bid for the reporting issuer,
 - iii. or a person or company that is proposing to be involved in a merger, reorganization or similar transaction with the reporting issuer, or to acquire a substantial portion of the property of the reporting issuer.

Terminology in (a):

1. s. 1(c) – “**associate**”: a person or C who owns directly / indirectly greater than 10% of the voting rights of a RI; any partner of that person or C; any trust / estate in which that person or C is a trustee or has a substantial beneficial interest, or in the case of a person, that person’s spouse, or child or relative living at the same residence
 - s. 2 – “**affiliation**”: an issuer is affiliated within another issuer if one of them is the subsidiary of the other or if each of them is controlled by the same person or C
- (b) They have engaged in, are engaging in, or propose to engage in, any business or professional activity with either the reporting issuer, or with any person or company that is described above.
- Law firm that represents pubco is in a special relationship.
 - Providing legal advice, consulting advice...w/ either public co itself, or someone looking to take-over or merge w/ public co, then are in a special relationship w/ that public co. This would catch a law firm providing advice to a public co, or providing advice to a co looking to take over another co.
- (c) They are a director, officer or employee of the reporting issuer or any of the persons or companies described above.
- Secretary or paralegal
 - Lawyer for co that is going to merge w/ public co is in a special relationship w/ public co, as is that lawyer’s secretary
- (d) They learned of a material fact while they were a person described above.
- May have quit but if you learned of material fact while employed there then you are in a special relationship.
- (e) They learned of a material fact from any person described above, or described in this item, **and** they know, or ought reasonably to know, that the person they learned the material fact from was in a special relationship.
- And person who is told this then tells someone else--> then "someone else" is in a special relationship too. This could carry on indefinitely.

Material Fact – Section 1(gg)

A fact that would reasonably be expected to have a significant effect, on the market price or value of the securities.

- A little different than material change: this does not have to represent a "change", a fact or existing circumstance counts here too.
- inside information is a material fact that is not generally known to the public.
- Note – a material fact is arguably broader than a material change.

Reporting Insider – NI 55-104 s. 1.1 (new national instrument)--who has to file insider reports (not all special relationships have to file an insider report)--only “reporting insiders” are required to file insider reports:

- CFO, CEO or COO of the reporting issuer, of a significant shareholder (10%) of the reporting issuer or of a major subsidiary of the reporting issuer.
 - Major subsid: one that contributes more than 30% of the total assets or revenue of the pubco.
 - So not every officer of RI, etc. has to file an insider report
- A director of the reporting issuer, of a significant shareholder of the reporting issuer or of a major subsidiary of the reporting issuer.
 - So every director has file
- A person responsible for a principal business unit, division or function of the reporting issuer.
 - Manager of our tupperware division will be a reporting insider
- A significant shareholder of the reporting issuer.
 - More than 10%
- A significant shareholder and the CEO, CFO, COO and every director of the significant shareholder, based on post-conversion beneficial ownership.
 - X Corp that owns more than 10% of RI. CEO of X Corp must file.
 - 10% is based on a post-conversion or dilution basis.
- Any management company that provides significant management or administrative services to the reporting issuer or a major subsidiary, and every director, CFO, CEO, COO and significant shareholder of the management company.

- This catches President of company--he may not be EE of company. Rather, the RI may be in an employment K thru with the President's management company.
- An individual performing functions similar to those performed by the persons described above.
 - Doesn't matter if he is called CFO, if that's his role then he is a reporting insider.
- The reporting issuer itself it is has acquired its own securities and continues to hold them.
- Any other insider that:
 - i) in the ordinary course receives or has access to information as to material facts or material changes concerning the reporting issuer before they are generally disclosed; **and**
 - (ii) directly or indirectly, exercises, or has the ability to exercise, significant power or influence over the business, operations, capital or development of the reporting issuer.
 - I am an insider and I normally have access to insider information and have sig influence over the business.

Reporting Requirements (what do we have to report as a reporting insider)

- A person must file a report of their direct and indirect ownership of or control or direction over securities of the issuer upon becoming an insider of a reporting issuer [S. 182(1)] and a further report if there are any changes in their ownership, control or direction [s. 182(2)].
 - I am Joe Blow and this is how i am an insider. If Joe buys more then he must report this.
 - Over securities: security is a share, option, etc.
- To be filed within 10 days (R. 190). (Under new rule it will be 5 days for subsequent report.)
 - This report must be filed within 10 days of becoming an insider or within 10 days of a change (subsequent report). 3 days for someone else...
 - Deemed insiders have to report stuff for the past 6 months.
- To be filed in accordance with NI 55-102 (R. 182).
- Insider reports are filed electronically through SEDI (NI 55-102).

Exemptions of when a Reporting Insider does not have to file an insider report

- s.183 of the regs: we don't have to file a nil report-if we don't own any securities in a corp don't have to file a report saying we own 0 securities. But remember securities includes options, convertible securities, etc.
- Don't have to file duplicate reports where we have direct and indirect holdings.
 - Ex. I am president of corp that makes me an insider, but I don't own the shares directly, own them thru a holding co. Holding co has more than 10% so it is an insider. 2 different reports which say the same the thing we just have to file 1 report. I own these shares indirectly, Holdco does not have to file.
- NI 55-101: if you are an insider by virtue of being a D and O of a subsid or affiliated corp then you don't have to file insider report unless you ordinarily have access to material info about parent. If it is a minor subsid then the D and O don't have to file a report.
- 55-101: Don't have to file reports every time a purchase is made under an automatic purchase plan. Ex. EE share purchase plan, every month take some of your salary and use it to buy shares in the company. Rather, at the end of the year, file 1 report, must be filed within 90 days of the end of the calendar year. Must file a report sooner then 90 days if you sold shares.
 - 55-104: new rule: year end report must be filed by Mar 31st.
- 55-104: options granted under a stock option plan. Automatic purchases every month, stock options are granted at the discretion of the board and that this plan has been disclosed in their information circular and the company itself files an issuer grant report then you don't have to file individual report at time of the grant. Have to file by Mar 31st.
- Reports are filed on SEDI.
- An issuer on SEDI must file an issue event report: when corp does something that it will effect every SH in the same way. Ex. A stock split. If you have 1 share you now have 2. if you had 2, now 4.
- If you are an insider of many corp's you will only have 1 insider profile.

Trading on Inside Information

- Trading while in possession of undisclosed material facts (this includes insiders and persons in special relationships)

- **Section 147**

- No person in a special relationship with a reporting issuer shall purchase or sell securities of that reporting issuer with knowledge of a material fact or material change that has not been generally disclosed.
- No reporting issuer or person in a special relationship with a reporting issuer shall, other than when necessary in the course of business, inform another person or company of a material fact or material change that has not been generally disclosed.
 - President can talk to his lawyer, but can't tell his wife or friends at the bar
 - Prohibits trading and informing others
 - Remember special relationship includes someone who receives info from someone who is an insider. So wife now becomes in a special relationship and can't buy shares.
 - Ex. Martha Stewart. President of Imclone found out they were going to turn down his pharmaceutical application. So he told some friends and they all sold their shares. He told his stock broker, stock broker tells Martha, and she sold her shares. President, stock broker and Martha are all in a special relationship.

If a person contravenes s. 147 there are 3 kinds of sanctions: Penal, administrative and civil remedies. You could be nailed by all 3.

(1)--Penal Sanctions - Section 194

If a person contravenes section 147 (trade on inside information) they are liable to

- (a) imprisonment for a term of not more than 5 years less a day, or
- (b) a fine of:
 - (i) not less than the **profit** made or loss avoided by the person (minimum fine is how much you made or avoided), and
 - (ii) not more than the greater of \$5,000,000 or 3 times the profit made by the person,or both a fine and imprisonment.

s.195(2)(b): "Profit" (or loss avoided) will be calculated as the difference between the "market price" (being the weighted average trading price over the first 20 days after the general disclosure of the material fact or material change) and either the lowest price paid by the person (in the case of a purchase) or the highest price received (in the case of a sale), multiplied by the number of securities purchased or sold.

(2)--Civil Liability – Section 207

- A person in a special relationship with a reporting issuer that trades with knowledge of an undisclosed material fact or material change or who informs another person of an undisclosed material fact or material change is liable to compensate any person that suffers damages as a result of that trade or informing (joint and several liability).
 - Anyone who purchased or sold at the same time I did my insider trading. I bought at that time, I get compensated for my loss. So other SH's can sue insider.
- If the person in the special relationship is an insider they are also accountable to the reporting issuer for any benefit or advantage received.
 - The RI itself can make this person account for any adv they received. Pay the profit over to RI and we will give this money to our SH's. If they don't, any SH or SC can apply to the court for permission to commence that action in the name of the company (derivative action).

(3)--Administrative sanctions – Section 198, 199--SC can order these:

- Cease trade order.
 - They do not have to make a finding that you violated the act, just have to determine that is in public interest to issue that order.
- Prohibition on being a director or officer of any issuer.
 - They do not have to make a finding that you violated the act, just have to determine that is in public interest to issue that order.
- Administrative penalty of up to \$1 million.

- Order you to pay costs of investigation

Defences (for both penal and civil sanctions)

- 147(5) penal defences. Civil defences: 207(2)
- The person had a reasonable belief that the information had been generally disclosed.
- The other person to the trade (the buyer/seller) knew or ought reasonably to have known the same material fact or change. We both knew the same info.
- The transaction took place under an automatic share purchase plan or other automatic plan entered into **before** the person acquired the inside information.
- The trade was made pursuant to a legal obligation entered into **before** the person acquired knowledge of the material fact or change.

RI's don't like it when their people trade on insider information

- RI's set up Black out periods--2 types
 - Ad hoc: whenever the corp is engaged in a big deal there is a black out, no insiders can buy or sell while we are in ad hoc
 - If you want to buy or sell you have to notify the designated person, and they will tell you if company is in a blackout.
 - Reoccurring black out period wrt the issuance of co's financial statements. Some of the info could be material. 2 days before end of quarter until financial statements have been released.
- When there is something going on, corp will put up Chinese walls (prevent leaks of info). Only top executives will know about the deal.

Cue card question

- How can lawyers invest in client shares without insider liability
 - When can you sell them? Have to be careful, is the info insider info
 - You are in a special relationship with client.
 - Be wary of conflicts of interest when you are a SH: telling D what to do what is in best interests of corp. Best interest of corp is to do something to dilute shares but you are a SH
- US insider trading rules are very similar to Canadian law
 - Short swing rule: an insider that has both bought and sold within 6 months then RI can sue you for any profits that you made.

CH 6: TAKE-OVER BIDS (AND ISSUER BIDS)

- MI 61-101 only applies to RI's in ON and QC.
 - If you are trading on TSX or CNSX you are a RI in ON and this instrument will apply
 - As a condition of being recognized by ON SC, the TSX V exchange agreed that it would enforce this instrument on companies on its exchange. So by law you don't have to comply with it, but TSX-V will enforce this on its companies.
- Why do we have TOB rules→To protect the integrity of our capital markets. Do this by 2 mechanisms
 - Want to make sure all SH's are treated equally. Just cuz you are president doesn't mean you get a better deal
 - Provide a company and anyone else in market an opportunity to respond to a TOB. If there is a better offer out there company needs to hear about it to get best value for our SH's.

What is a Take-Over Bid – MI 62-104 s. 1.1

- An offer to acquire voting securities or equity securities of a class made to one or more persons who reside in the local jurisdiction (or whose last address is in the local jurisdiction) where the securities that are subject to the

offer, together with the offeror's existing securities (shares of target that I already own), will constitute 20% or more of the outstanding securities of that class.

- How much I want to buy + how much I own-->does this put me in a 20% position if the offer is accepted. Over 20% is a control person.
- Only dealing with voting and equity securities.
- If I already own more than 20%, if I make an offer to buy 1 share that is a takeover bid.

Deeming rules to figure out if this is a TOB (calculating the number of securities):

1. If an offeror is acting jointly or in concert with another person then the securities owned by that other person are included in calculating the number of securities owned by the offeror and in calculating the number of securities that are subject to the take-over bid any offer made by that other person is included [s. 18(3)].

- I own 6% and offer to buy 6%. Guy I work with owns 6% and offers to buy 6%. This is 24%.

2. In calculating the number of securities owned by the offeror, the offeror is deemed to own those securities that are issuable upon the exercise of any convertible securities or options, warrants or other rights that the offeror has the right to exercise within 60 days of the date of determination [s. 1.8(1)].

- Take into account convertible securities (any securities that we can convert into the class that we are offering to buy) then I pretend that I have exercised. Add them to my existing shares.
- Numerator (how many shares I own plus how many shares I am offering to acquire). Denominator – how many shares outstanding. If there are 10 million shares outstanding and I own 1 million and I am offering to acquire 2 million: $3,000,000/10,000,000$.
 - If there are 100,000 options numerator becomes 3.1 and denominator becomes 10.1 – changes both numbers to make diluted calculation. S.158(4/6)

TOB rules apply to any issuer in a jurisdiction, it is not limited to RI's. Thus it applies to private companies.

→ Rules apply to all issuers whether or not they are in or out of the closed system.

TOB rules are formal and time consuming, where-ever possible want to avoid complying with TOB rules. There are a number of exemptions to help us avoid them.

Exemptions – Part 4

4.1 Normal course purchases. A take-over bid where:

- (i) the number of shares purchased does not exceed 5% of the outstanding shares of that class
 - A single transaction cannot exceed more than 5%
- (ii) the total number of shares purchased in reliance on this exemption in any 12 month period can not exceed 5% of the outstanding shares at the beginning of that 12 month period,
 - Over the course of a full year I can only pick up 5%. I can't buy 5% each week.
- (iii) there is a published market for the securities, **and**
- (iv) you do not pay any more for the shares than the prevailing market price, including reasonable brokerage fees and actual commissions paid.
 - I cannot pay more than the prevailing market price. No SH out there is getting a benefit by selling privately to me instead of thru the market.

4.2 Private Transaction. A take-over bid that is not made to the shareholders generally, is not made to more than 5 people, and the price paid does not exceed 115% of the market price.

- This is not an open offer.
- Can't exceed 115%: so can't pay existing SH like the President a premium for selling us his shares. He doesn't get to make a huge profit as compared to the other SH's.

4.3 Non-reporting issuer. A take-over bid where the offeree issuer (target co) is not a reporting issuer, there is no published market for the securities, and there are no more than 50 holders of the class of securities subject to the offer (exclusive of employees and former employees).

- Exemption for private issuers

4.4 Foreign take-over bid A take-over bid where:

- (i) Canadians own less than 10% of the outstanding securities, based on the registered shareholder list;
 - Less than 10% of registered SH's are Canadians
- (ii) the offeror reasonably believes that Canadians beneficially own less than 10% of the outstanding shares;
- (iii) in the past 12 months the greatest volume of trading of the company took place on a market outside Canada;
- (iv) security holders in the (Canada) local jurisdiction participate in the bid on terms at least as favorable as offered generally; and
 - Canadian SH's have to be offered same terms as all other SH's in the world
- (v) the offeror files and sends to Canadian security holders a copy of the bid materials [with a summary prepared in English (or French in Quebec), if applicable] at the same time, or if there is no bid material sent but a notice is published in the foreign jurisdiction, then a notice must be published in at least one major daily newspaper in the local jurisdiction.
 - Foreign TOB and there are few Canadians involved, will exempt TOB so long as you treat Canadian SH's the same as the other SH's

4.5 De Minimus exemption. A take-over bid where:

- (i) there are less than 50 shareholders in the local jurisdiction
- (ii) the shareholders in the local jurisdiction hold less than 2% of the total outstanding shares of that class,
- (iii) the shareholders in the local jurisdiction participate in the bid on terms at least as favorable as offered generally, and
 - They offered the same deal as everyone else.
- (iv) the takeover bid materials are filed and sent to the shareholders in the local jurisdiction.
 - Send them the same info.
 - Most of SH's are in ON and some are in AB, you are exempt from AB requirements, just comply with ON requirements.

If you do not fall under one of these exemptions, TOB has to follow formal takeover bid requirements.

Formal Take-Over Bids—Process and Rules

The Process → ensures SH's are treated equally and let other people in the market respond to the bid)

1. The first step in the TOB process is the “commencement” of the bid. **The bid is commenced by** delivering the bid to the shareholders, or by way of an advertisement in a newspaper of general and regular paid circulation in the local jurisdiction. (s. 2.9)

- Deliver bid to SH's. We offering to buy so many shares of company. Bid starts when SH receives it
 - Must send a copy of this commencement to the company and the SC.
 - ABCA: can ask company for SH list before you send out commencement, corp has 10 days to get it to you.
- Put ad in paper. Bid starts on date of paper ad
 - On same day it is published, must send it to company and SC on the same day and ask company for a SH list. Within 2 days of getting list then must send bid out to SH's. If you want to catch company by surprise do it this way. Only 2 day notice.

2). The formal bid is to include a take-over bid circular, in accordance with Form 62-104F1 [s. 2.10(1)]. This would include prospectus level information if it is a share exchange take-over bid.

- This circular tells about the bid (offering to buy this many shares for this much). If offering shares of myself (share for share exchange) then this circular must contain prospectus level info of the purchasing company.

3) Within 15 days of the start of the bid, the directors of the target corporation must send out to the shareholders a **directors' circular**, in accordance with Form 62-104F3 [s. 2.17].

- This circular tells SH's if they like bid or not (their recommendation). If they say we are not sure yet, must get back to SH at least 7 days before the bid expires.
- An individual director or officer can send out their own circular (Form 62-104F4) [s. 2.20] at the expense of the company.

- If there is change in the information in a directors' or officer's circular a notice of change must be sent out. [s. 2.18]
 - To make this recommendation, companies take steps
 - Appoint an independent committee of the board to review the offer. If president is on BOD and company is taken over his job is on the line so he might not make a fair interpretation of the offer. Don't put President on independent committee.
 - This committee will likely get an independent opinion to help them make a recommendation of whether the bid is a good one or not.
4. The bid must remain open for a period of at least 35 days [s. 2.28] and the offeror cannot take up (purchase) any shares deposited under the bid for at least 35 days [s. 2.29].
- The longer a TOB the better chance a company has to find an alternative bid or take evasive measures.
 - Ex. Individual SH sells shares to bidder on first day, but bidder can't buy or take them up until after the 35 days.
- 5). Provided that the conditions of the bid have been satisfied, the shares that are deposited under the bid must be taken up and paid for within the earlier of [s.2.32]:
- (i) 10 days after the expiry of the bid, if deposited prior to the expiry,
 - (ii) 10 days of being deposited, if deposited after the first take up,
- and must be paid for as soon as possible and, in any event, within 3 business days of being taken up.
- Taken up: i am going to buy them
 - "Paid for": writing a chq for the shares I have taken up
 - (ii)-More shares are deposited after the first take up.
 - Provided that the conditions have been satisfied
 - Common condition: offeror says my bid is conditional upon me getting at least 50% of the shares. If only 40% are tendered, I don't buy any of them and I said them back. If 65% is sent in, condition is satisfied and I have to buy at least 50%.
6. If there is a variation in the bid, or a material change in the information contained in the circular, at any time prior to the expiry of the bid or prior to the expiry of any withdrawal rights, then a news release is issued and a notice of the change is to be sent to all shareholders whose shares have not yet been taken up. [s. 2.12]
- Variation in bid: increase the price, or I only need 40% instead of 45%. The expiry date cannot be less than 10 days after sending the notice unless my variation consists of waiving one of my conditions and it is a straight cash bid (don't have to extend expiry date here). ex. bid is open for 35 days, on day 32 send out notice, the bid must now stay open until at least day 42.
 - If my bid is already expired I cannot vary any of the terms of my bid except to waive a condition that I said in my bid circular that i would reserve the right to waive.
 - In circular says, I might waive that requirement. Condition is 50% only get 45% but i said i could waive it then i can even if bid has expired.
 - Material change in company: target co's plant burnt down or my company that I am offering shares (purchasing co) in there has been a material change.
- 7). If the terms and conditions of the bid have been satisfied or waived, on expiry of the bid the offeror must promptly issue a news release disclosing approximately how many shares were tendered and approximately how many shares will be taken up. [s. 2.34]
- I offered to buy 50%-60% and I got 69% tendered, I will buy 50%.
 - Following the expiry, if the offeror knows that it will not be taking up securities deposited, it must promptly issue a news release to that effect and return the securities. [s. 2.33]
8. Shareholders who have deposited their shares under a bid can withdraw them at any time up to:
- (a) Any time before the shares are actually taken up;
 - (b) Within 10 days of the notice of a change or variation;
 - Day 32, bid changes, I have 10 days to get my tender back.

(c) If the shares have not been paid for within the 3 business days of being taken up [s.2.30(1)]

In the event of a withdrawal right arising upon a notice of a change or variation, the right will not apply if (withdrawal right does not apply in all cases):

- (i) the shares have already been taken up,
 - (ii) the variation in the bid consists only of an increase in the consideration offered and the time for deposit is not extended beyond the 10 days required in the case of a variation, or
 - (iii) the bid is a straight cash bid and the variation is just the waiver of a condition.
- [s. 2.30(2)].

The (significant) Rules wrt a formal TOB

1. The bid must be made to all shareholders [that own shares of that class] and the must be offered identical consideration.[s. 2.23]
 - Ex. Offeror could offer \$10 cash per share or a \$15 of stock in my company. Thus, the same offer is made to all SH's but all SH's don't have to accept the same consideration.
 - If I increase my price, I must pay that same consideration to everyone including to SH's that I have already bought and paid for. Ex. Original offer was \$10, later I bump it up to \$11, must send a \$1 per share to all the SH's that sold at \$10.
2. Any collateral agreement that would result in any shareholder getting consideration of greater value than offered to other shareholders is expressly forbidden.[s. 2.24]
 - All SH must be treated equally--no side deals.
 - **This prohibition does not apply to employment compensation arrangements.** Ex. severance. This is how you get the President's shares. **If a benefit is offered to EE's it must be offered to all EE's who are in a similar position** (few exceptions to this below). 10 VPs, must be offered to all 10 VP's.
 - If not offered to similar EE's:
 - If not offered to everyone in similar position then person who it is offered to must not own more than 1% of the shares of target corp.
 - An independent committee of the board must determine in good faith that benefit that EE is getting is not worth more than 5% of the value they would get for their shares and they are providing at least an equivalent for that benefit.
3. Between the time that a bid is commenced and when it expires, an offeror cannot buy any shares of the target issuer, except through the bid, unless (a) in the circular (or in a notice of change) it said it was going to do so, (b) it does not buy more than 5% of the total outstanding shares, (c) the purchases are made in the normal course on a published market (no private deals), **and** (d) it issues and files a press release on each day that it buys shares. [s. 2.2]
 - Can not sell any shares of the target during the bid. [s.2.7] unless I have said in my circular that I will sell the shares that I pick up to someone else.
- 4). From the commencement of the bid until 20 business days after the expiration of the bid, the offeror cannot buy any shares by way of a private transaction. [s. 2.5].
 - Can't make private deals to buy any shares until 20 days have gone by since expiry.
5. If the offeror has bought any shares in a private transaction within the 90 days prior to the start of the bid, then the consideration offered under the bid must be at least equal to the highest consideration (or the cash equivalent) paid under the private transactions(s), and must offer to purchase a percentage of shares at least equal to the highest percentage purchased from any seller in the private transaction(s) [s. 2.4(1)].
 - If i bought shares before the bid in a private deal (90 days before bid), then I have to make the same offer to all other SH's in terms of price and percentage of shares. Ex. I bought President's shares at \$10 a share and I bought 80% of his shares then this is the offer I have to make to all of the other SH's.
6. If the bid is for less than all of the outstanding shares, and there are shares tendered for more than that maximum number, then the offeror shall purchase that number from all of the tendering shareholders on as nearly a proportionate basis as possible, ignoring fractions [s. 2.26)].
 - Don't want 100% of company. I can set maximum number of shares I want to buy.
 - It is not a first come first serve basis: Everyone is treated proportionally the same. I wanted 50% of the company and all SH's tender their shares → I buy 50% from Joe, 50% from Sally

- Acquires shares privately before bid, 2 exceptions to proportionately
 - I can be disproportionate to avoid odd lots. Shares on stock exchange trade in lots. You can't buy 22 shares you have to buy 100 if the lot size is 100. this guy will be left with an odd lot, so I can bump him up or bump him down--he is not getting proportionate treatment
 - Dutch auction: i will take so many shares if offered above a certain price. Hank tenders his shares at minimum price of \$8,, Joe offers \$10. I can take shares at minimum prices and not ones at higher asking prices.

7). If the bid is conditional upon the offeror getting a minimum number of shares tendered, and the offeror purchases additional shares outside of the bid, then those additional shares shall be counted towards meeting the minimum requirement, but they will not reduce the amount that the offeror is obligated to take up (e.g. if the bid set both a minimum and a maximum) [s. 2.31].

- Does not reduce maximum that I am obligated to buy. Bid is conditional of getting a million shares tendered, but I won't buy more than 2 million shares. I go in market and buy 500K shares and another 600K are tendered I cant say i only got 600K my condition is not met. No, you have 1.1 million and the condition is satisfied. Or i bought 500K outside bid, and 1.8 were tendered, I have to take all 1.8 million + 500K I already bought.

8. If the bid includes, in whole or in part, a cash offer, then the offeror is required, prior to the bid, to make adequate arrangements to pay for all the shares that they have offered to acquire [s. 2.27]. Form 62-104F1 (item 12) requires the offeror to disclose those arrangements.

- Purchaser must have cash available to pay for all shares that are tendered. And i must disclose what those arrangements are in the circular.

Aspects related to take over bids:

Valuations (valuation of company)

Under Ontario/Quebec MI 61-101 the takeover bid circular is to provide disclosure of a current valuation (within 120 days) where the bid is an "insider bid".

- There is no formal requirement to have valuation done for take over. But if the bid is an insider bid then the circular must disclose valuations as per Securities Legislation.
- For us this is relevant if the co is a reporting issuer on TSX or TSX-V (this exchange enforces 61-101, thus you must comply with valuations).
- In the case of a takeover bid, must offer to all SH's to a company (if not an exempt takeover), thus you must worry about where all the SH's reside. If they reside in ON and QC you are making the offer there and must comply with local laws there (61-101). Registered SH's have their shares thru brokerage firms, most brokerage firms are in ON.
- 61-101: Formal valuation in the case of an insider bid. If you are pres of company and want to buy out rest of co that is an insider bid and as a result a formal valuation would have to be done (included in takeover circular)

Compulsory Acquisition

Section 195 of the ABCA gives an offeror the right to compel dissenting shareholders to sell their shares either for the original offer consideration or for "fair value", provided that the offeror acquires at least 90% of the outstanding shares that they did not already own.

- If you want to takeover company sometimes you just want over 51%, but sometimes you want all of it. No assurance you will get 100% of the SH's to get on board. Can you get rid of the objecting minority? Yes:
 - **Compulsory acquisition**--s.195: if buyer gets at least 90% you can force remaining 10% to sell to me. This is 90% of what I did not already own. If i started out owning 20% of shares that means you must get 90% of the remaining at 80% (which is around 92% overall). I have to acquire 90% within expiry of bid or 120 days from when it commenced.
 - s.196: offeror's notice must be sent out to remaining minority SH's within 60 days after the date of termination or 180 days after bid commenced.
 - SH have 20 days to decide if they will sell to you at that price (original bid offer consideration) or seek to be paid a fair value. Fair value is determined by a court. If don't respond within 20 days, deemed to have accepted the offer.

- What if you don't get 90%, how else can we get rid of minority
- **Squeeze out amalgamation:**
 - Buyer thru its subco acquires 80% of target co. Acquiror creates a brand new holdco and amalgamates holdco with the target. After the amalgamation, the minority SH's will be issued redeemable PS with a redemption price equal to price we offered in our takeover bid.
 - Result: Target co has 2 types of SH
 - Acquiror has 100% of voting shares
 - Minority SH's have 100% of redeemable shares.
 - Acquiror redeems Minority's shares and gets 100% of target co
 - Amalgamation requires SH approval by special resolution (2/3 of voting shares). **That means if I acquire at least 67% of outstanding shares, I can guarantee that my amalgamation will be passed-- get rid of the minority.**
 - Amalgamation is also gives rise to a right of dissent. Minority SH can dissent, this entitles SH to be paid fair value of their shares. SH is paid out and he is gone.
 - When making a takeover bid, don't need to make it subject to getting 90%, just make it subject to 67% of shares that vote.
 - 61-101: requires a formal valuation to be done for a follow up business combination if it involves an interested party (majority SH), but it doesn't apply to a second step business combination that is completed within 120 days of the expiry of the bid.

Cue card question--how do you defend a company from a hostile takeover

- Shark repellants
 - Put in place ahead of time so potential bidders know what will happen if they make a hostile bid.
 - 1 type: golden handshake or golden parachute
 - CEO has agreement with company that says if he gets taken over (co changes control) then CEO has period of time to decide if they want to stick around, if I don't want to stay I get my severance package.
 - 2nd type: crown jewels
 - If change of control founder has option to buy back certain assets of company on favorable terms (key assets may get stripped out--not a nice looking target)
- Once bid is in place, solicit other bids--defensive tactic to get a white knight (someone we like at a higher bid).
- Poison pill: it is a rights offering to SH's--option to buy more shares to company. If there is a hostile bid, then every SH in co except bidder will have right to buy 100 new shares for a penny. This dilutes the shares. Hostile guy has 20% and then rights get exercised, hostile guy now has 2%.
- Best defense: President have most of the shares

Issuer Bid

Means an offer to acquire or redeem securities of an issuer made by that issuer, made to one or more persons in the local jurisdiction, and includes an acquisition or redemption.

- I have pubco, pubco wants to buy back some of its own shares or redeem them-->this is an issuer bid. Note that there is no 20% threshold; therefore, if co offers to buyback 1 share that is an issuer bid.
- Excludes non-convertible debt securities (iou, loan) of the company.-->repaying a loan is not an issuer bid.
- Excludes transactions that are a step in an amalgamation or reorganization that requires SH approval.
 - Part of big transaction, I have to redeem before I issue new ones.-->not an issuer bid
- Issuer bids are subject to most the same rules as take-over bids.
- Bid = a takeover "bid" and an issuer "bid". Process, mechanics and restrictions are mostly the same.
 - Issuer bid circular 62-104F2.

Exemptions (to not have to do an issuer bid)

Issuer Acquisition or Redemption (s. 4.6)

- (a) The redemption, or other purchase, of securities that, by their terms, are redeemable by the issuer without the prior agreement of the owner, or are purchased to meet sinking fund requirements.
 - Issued redeemable PS, I can redeem them and not have to do an issuer bid
- (b) The purchase, redemption or acquisition of securities where that redemption (purchase) is required by the instrument creating the securities or under the applicable [corporate] statute.
 - States it in our articles of corporation or we have an obligation to redeem them by statute.
- (c) The redemption or repurchase of securities pursuant to the exercise of a redemption (repurchase) right granted to the owner.
 - Owner of share can force co to buy them back

Employee, Executive Officer, Director, Consultant (s. 4.7)

A purchase from an employee or former employees if:

- (i) the purchase price is not above the market price, and
- (ii) the total purchases under this exemption in any 12 month period does not exceed 5% of the outstanding shares at the beginning of at period.
 - EE's when they leave, sell us any shares that they have.

Stock Exchange Issuer Bid [s. 4.8(2)]

An issuer bid made through the facilities of a recognized stock exchange according to its rules.

Normal Course Issuer Bid [s. 4.8(3)]

An issuer bid where:

- (i) The bid is for not more than 5% of the outstanding shares.
- (ii) the total purchases under this exemption in any 12 month period does not exceed 5% of the outstanding shares at the beginning of that period.
- (iii) the consideration paid does not exceed the market price, plus reasonable commissions.
- Both normal course and exchange bid exemptions have press release rules. These are the 2 most common issuer bid exemptions

Private issuer (s. 4.9)

An issuer bid where the issuer is not a reporting issuer, there is no published market for the securities, and there are no more than 50 holders of the class of securities subject to the offer (exclusive of employees).

- Not a RI, no published market for securities...it is exempt

Foreign issuer bid (s. 4.10)

A take-over bid (in a foreign jurisdiction) where:

- (i) Canadians own less than 10% of the outstanding securities, based on the registered shareholder list;
- (ii) the offeror reasonably believes that Canadians beneficially own less than 10% of the outstanding shares;
- (iii) in the past 12 months the greatest volume of trading took place on a market outside Canada;
- (iv) securities holders in the local jurisdiction participate in the bid on terms at least as favorable as offered generally;
- (v) the offeror files and sends to Canadian security holders a copy of the bid materials [with a summary prepared in English (or French in Quebec), if applicable] at the same time, or if there is no bid material sent but a notice is published in the foreign jurisdiction, then a notice must be published in at least one major daily newspaper in the local jurisdiction.
- Exempt from the Canadian requirements

De Minimus exemption (s. 4.11)

An issuer bid where:

- (i) there are less than 50 shareholders in the local jurisdiction
- (ii) the shareholders in the local jurisdiction hold less than 2% of the total outstanding shares of that class,

- (iii) Shareholders in the local jurisdiction are entitled participate in the bid on terms at least as favorable as offered generally, and
- (iv) the takeover bid materials prepared under the rules of that other jurisdiction are sent to the local shareholders and filed with the Commission.

When dealing with issuer bids, must worry about corp requirements too. ABCA says a corp is not allowed to own shares in itself unless holding it as a trustee for someone else. If they acquire their own they get cancelled and returned to treasury.

- ABCA s.34:
 - insolvency test: a co cannot buy back its own securities unless it is able to pay its liabilities as they become due, or
 - Liquidity test: the realizable value of the corp's assets would after the payment be less than the aggregate of its liabilities and stated capital of all classes
- A company that owns shares in itself is an insider until it cancels them and is required to file an insider report. Issuer bid exemption: have 10 days after month end to file this insider report.

Early Warning – Part 5--62-104

• Reporting requirement known as early warning disclosure--early warning in event of possible takeover bid. Upon acquiring (other than through a formal bid) securities that constitute 10% or more of the outstanding securities of a reporting issuer (taking into account convertible securities held by the person--options, convertible debt, warrants, etc.) that person shall issue an early warning report:

1. "Promptly" issue and file a news release (Appendix E of NI 62-103), and
 2. Within 2 business days file a report containing the same information on SEDAR.
- After that, Further release and report required (within same time frames) **where an additional 2%** is acquired or there is a material change in a material fact in a previous report.
 - May not purchase any additional securities of that class, or convertible into that class, between the occurrence of the triggering event and one business day after the report is filed (unless the person owns more than 20%). Then have to worry about takeover rules once you over 20%.
 - Where there is a formal TO bid in progress, then the threshold for the initial early warning report is lowered to 5% [s. 5.3].
 - These do not replace insider requirements. If i own more than 10% i am insider, if you get to 10% must immediately issue news release and then within 10 days file insider report.

What does report say--Report to include--62-103:

- (a) The name of the person and any persons they are acting in concert with, the number and percentage of shares acquired (including by any person acting jointly or in concert),
- (b) the number and percentage of shares owned after the acquisition (including by any person acting jointly or in concert),
- (c) the market in which the transaction took place,
- (d) the purpose of the acquisition and any future intentions to acquire additional securities, and
- (e) information respecting any agreement entered into respecting the acquisition, holding, disposition or voting of shares.
 - Agreed to sell them to someone else, agreement to buy more, agreement to give the voting rights away.