

- □ **I. TECHNICAL OUTLINE**
- □ **II. chapter 4: prospectus requirement**
  - □ **A. contents of a prospectus**
    - □ 1. BCSA s. 63, NI 41-101 sets out requirements for prospectus content
      - □ a) see list on text page 112
        - □ (1) note: list can be broken down into securities offering info (attributes, rights, etc) and info on the issuer
        - □ (2) note that several things referred to as footnotes in the text have now been changed, etc
      - □ 2. disclosure in a prospectus is open-ended: it must provide full, true and plain disclosure of all material facts as defined in s. 1(1) BCSA
        - □ a) a material fact is one that significantly affects, or would reasonably be expected to have a significant effect, on the market price or value of the securities
      - □ 3. inclusion of future oriented financial information
        - □ a) 51-102F1 (g): future-oriented financial information may be included in MD&A in a prospectus that relates to prospective results of operations, financial position or changes in financial position based on assumptions about future economic conditions and courses of action taken by the issuer
        - □ b) issuers must comply with para 4A and 4B of NI 51-102 - but can find in statute under part 5.5(1), (2), (3), (4)
        - □ c) issuer may not disclose forward looking information unless the purpose of including it is stated, it is identified as forward looking information and the results may vary, and the material factors and assumptions used in making the forward looking information is stated
        - □ d) also see BCSC rule 115 re FOFI
      - □ 4. officer of issuer is required to sign certificate stating that the prospectus contains a full and true disclosure of the material facts - this is a representation
    - □ **B. when is a prospectus required?**
      - □ 1. s. 61: no person shall trade in a security where such a trade would be a distribution of such security, unless a preliminary prospectus and a prospectus have been filed and receipts therefore obtained from the director
        - □ a) distribute is defined as including a trade in s. 1(1)
      - □ 2. s. 61 and the three questions for determining when a security is required:
        - □ a) does the transaction involve a "security"?

- b) does the transaction involve a "trade"?
  - (1) s. 34 states that you cannot trade in a security unless you are registered - this means either the issuer must be registered, or they need to use an underwriter (who are registered)
  - c) does the "trade" in the "security" constitute a "distribution"?
    - (1) if a distribution, then the issuer must comply with prospectus requirements in Part 9 BCSCA
- C. meaning of "security"
  - 1. defined in s. 1(1)
    - a) includes things commonly known as securities, such as stocks, bonds, debentures, trust units, options, rights, warrants, etc
    - b) includes specific items which would normally involve an initial payment that will be used to produce some future returns
    - c) includes several "catch all" provisions to include an "interest in property", "profit sharing agreements" and "investment contracts"
  - 2. interest in property: *Brigadoon Scotch Distributors*
    - a) potentially including all interests in property could lead to daily transactions being unnecessarily impeded by securities regulations
    - b) the court stated that the definition does not include documents of title which are bought and sold for purposes other than investment, for example bills of lading and receipts of goods purchased for inventory
  - 3. profit sharing agreement: *Raymond Lee*
    - a) this term has not been given much significance and has not been defined in a way that goes beyond the term "investment contract"
    - b) RL would do patent work for inventors, and then would share in the profits - OSC found this to be a security, because of profit sharing agreement
    - c) court stated that some day a situation will arise where an arrangement is found to constitute a "profit sharing agreement" even though it is not also an investment contract
  - 4. investment contract
    - a) the "common enterprise test" from *Howey*:
      - (1) there is a contract, transaction or scheme whereby a person invests
      - (2) the investment is in common enterprise
        - i) *Pacific Coin*: common enterprise exists where the investor advances money while the success of the enterprise depends on the promoter - no need for enterprise to be common to the investors between themselves

- (3) the person is led to expect profits "solely" from the efforts of a promoter or 3rd party
  - i) *Pacific Coin* expands "solely" - question is whether the efforts of the third party are undeniably significant for the success of the enterprise
  - ii) the subsequent case of *Forman* defined profits to mean either capital appreciation or earnings
  - iii) the solely aspect of this element was also modified in *Glen T. Turner* to "the efforts made by those other than the investor and the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise"
- b) the "risk capital test" from *Hawaii*:
  - (1) the offeree furnish initial value
  - (2) a portion of the initial value is subjected to risks of the enterprise
  - (3) the furnishing of the initial value is induced by promises or representations leading to a reasonable expectation or understanding that a benefit above initial value will accrue
  - (4) the offeree does not have the right to exercise practical and actual control over the managerial decisions of the enterprise (this gets around the "solely" requirement in the *Howey* test)
- 5. *SEC v. CM Joiner*
  - a) involved selling leases in land, in 5-15 acre parcels, with promise that Joiner would drill test well to see if there was oil producing potential
  - b) court found that while the transactions were set up so that it looked like it was a transaction for an interest in land, there was more to it
  - c) definition of security defined broadly to meet purposes of Act
  - d) in this case, there may have been several things that investors needed information on, such as the oil and gas producing potential of the land, the structure of Joiner Corporation, background on Anthony and Joiner and their interests in the scheme, who would drill the test wells and what level of expertise they had
  - e) given that some investors would be rather small, the people in the best position to provide the necessary information were Joiner and Anthony, through issuing a prospectus
  - f) *SEC v. WJ Howey*
    - (1) see text page 123 for case details - this is the orange grove case
    - (2) the common enterprise test applied:

- i) there was more than just a sale of fee simple interests in land - people were attracted to the investment by the expectation of returns
- ii) the scheme would not work unless the interests were pooled in the common enterprise managed by Howey in the Hills, because it was not economical to cultivate and harvest small plots of groves individually
- iii) buyers expected to receive profits based on the work done by Howey in the Hills
- g) *State of Hawaii v. Hawaii Market Centre*
  - (1) see text page 124 for case details - this is the shopping club/pyramid scheme case
  - (2) Hawaii didn't like this scheme, but there was no criminal code provision to prosecute on, and the *Howey* test didn't apply because of the word "solely" within that test (because part of a new members profits was based upon their own efforts) - court sets out broader "risk capital" test
  - (3) risk capital test applied to the facts
    - i) the offeree provided initial value: they had to buy an overpriced cookware set or sewing machine
    - ii) a portion of the value (the amount above and beyond the value of the product) was based upon how well run the Hawaii Market Centre was run
    - iii) the purchase of the cookware/machine was induced by the potential to make money/commissions on the memberships that the offeree sold, as well as those under the offeree
    - iv) the offeree was not able to have control over the Hawaii Market Centre, which was crucial to the ability of the offeree to be successful
  - h) *Pacific Coast Coin Exchange v. OSC (SCC)*
    - (1) customers could buy bags of silver coins through Pacific Coast Coin Exchange - for a commission PC would deliver coins to its customers, the price of the coins were fixed several times each day by PC, and the price was the market value quoted by PC plus commissions and other charges
    - (2) customers could also buy coins on margin, which is how most of the purchases were done, and this is the issue in this case
    - (3) PC only kept a small inventory of the silver coins, covering some of the risk by buying silver futures contracts
    - (4) court adopts the tests from *Howey* and *Hawaii* to determine whether or not this was a security:

- i) risk to the investor that depended upon the success of the enterprise and the establishment of a true market
- ii) success of enterprise depended on the efforts of management of Pacific Coast in managing the pool of funds, and depended on how they invested the funds and the steps they took to reduce the risk of investment
- (5) in *Howey* "common enterprise test" court expands the concept so that it is not constrained by narrow interpretations of "common enterprise" and "solely"
- **D. the meaning of "trade" BCSA s. 1(1) definition**
  - 1. sale or disposition for *valuable consideration*
    - a) applies whether terms of payment be on margin, instalment or otherwise
    - b) covers both primary & secondary markets via wording "sale or disposition"
    - c) gifts of securities likely not caught: gifts lack *valuable consideration*
    - d) definition of trade does not include purchases of securities, since, at least with respect to distribution of securities, it is the vendor that is the object of the regulations and the purchaser that the legislation is trying to protect
  - 2. trades on behalf of others - para e
    - a) persons carrying out trades for others, such as a broker, are required to be registered and their activities are subject to extensive regulation
    - b) trade is defined to include participation as a trader in a transaction in a security on the floor of or through the facilities of an exchange" as well as "the receipt by a registrant of an order to buy or sell a security"
    - c) this includes anyone who receives an order to execute a trade - note that it is an offense to execute a trade unless registered/licenses to do so
  - 3. pre-sale activities - acts *in furtherance of a "trade"* - para f
    - a) because the sales pitch can involve sales tactics and possibly subtle misrepresentations that a buyer may rely upon, securities acts regulate this activity to prevent a potential loss in confidence in the market form such activities
    - b) to catch this sort of activity as "trade", trade is defined to include any act, advertisement, solocitation, etc directly or indirectly in furtherance of any of the activities described in the other branches of the definition
    - c) requiring some form of trade to be completed before a "furtherance" has occurred would unduly limit the legislation and its purpose - it is likely that injunctions could be ordered before a sale has actually happened
  - 4. open-ended nature of the definition

- a) trades is said to "include" certain things, and so as with "security" the definition has been left open to allow for a broad interpretation
- **E. meaning of "distribution" BCSA s. 1(1) definition**
  - 1. even where there was been a "trade" of a "security", a prospectus is only required when this trade in the security constitutes a "distribution", and therefore the meaning of distribution is quite important
  - 2. distribution, like security and trade, has been cast in broad terms
  - 3. trade in securities not previously listed - para a, text page 133
    - a) the most common distributions on securities will fall within this branch of the definition of distribution, where it means a trade in a security of an issuer that has not been previously issued - issue is not defined, but is commonly understood to mean the offer of securities for sale - issuer is defined to include a person or company that issues a security
  - 4. resale of securities returned to the issuer - para b, text page 134
    - a) where an issuer buys back securities or has them returned as a gift, in order to sell those securities again a prospectus must be provided because the issuer again may have access to new information that would be important
    - b) this doesn't happen a lot with Canadian companies, because most corporate statutes require that returned shares be cancelled
  - 5. sales by control persons - para c, text page 134
    - a) control person is defined as a person (or group of persons) who has sufficient control over voting rights to materially affect the control of the issuer
    - b) where one has 20% or more, they are "deemed" to be a control person - but you can also be a control person with less than 20%, if in a position to affect decisions some other way
    - c) where a person who is in a position to materially affect the control of the issuer, they are in a position to influence the affairs of the issuer in such a way as to distort or conceal information to get a better price
    - d) it could also mean that a substantial number of shares are being sold that will affect the market price, or that the control person, who may have been key to the companies success, will no longer be controlling the issuer
  - 6. deemed distributions on resale - para d, text page 135
    - a) where large institutional investors (banks, mutual funds, insurance companies, pension funds) buy securities, this is an exemption to the requirement for a prospectus

- b) however, if these large institutional investors go to re-sell the securities to individuals, a prospectus is required as a distribution is deemed to have occurred, as per BCSA s. 76

- **F. the distribution process**

- 1. pre-filing period: before filing the prospectus
  - a) prepare preliminary prospectus
  - b) due diligence - show that reasonable efforts were made to ensure that information in the prospectus is accurate - takes a couple months
- 2. filing of preliminary prospectus
  - a) must get a "receipt" for the preliminary
  - b) BCSA s. 63(2) - the preliminary prospectus must substantially comply - where it doesn't under s. 81 the executive director can order that trading permitted under s. 78(2) cease until the prelim prospectus is satisfactory
  - c) BCSA s. 65(1) - executive director has to provide a receipt once the prospectus substantially complies with the requirements
  - d) with the preliminary filing, other significant documents, such as a major contract or (for a mining/exploration) an expert report of the mining prospects of a piece of land, also included would be auditors comfort letter giving reasonable comfort that there have been no major changes since the last annual report/financial statements
- 3. the "waiting period" - BCSA s. 78
  - a) time period in between the receipt for preliminary and final prospectus
  - b) vetting of the preliminary prospectus by securities commission
    - (1) SC will assess whether required disclosure documents have been provided and if there are gaps in the information
    - (2) see ex NI 41-101 s. 21 - all commission is doing is saying that the requirements have been met, not that the security is a good one
  - c) if there are any adverse material changes in the issuer's business, the preliminary prospectus must be amended - NI 41-101 s. 6.5 (cited in text as s. 66 - repealed and moved to NI)
  - d) comment letter - issued after commission has done vetting, and provides comments on things missing in the preliminary prospectus and things that need to be dealt with/included/things that are not satisfactory
  - e) clearance period - period where company will deal with the comments from the securities commission to address concerns in the comment letters - once done approval will be given to file the final prospectus
  - f) s. 78(2) - selling activities during the waiting period are limited to:

- (1) can identify security
- (2) price if known (which often is unknown)
- (3) where it can be bought
- (4) can give out preliminary prospectus
- (5) can solicit expressions of interest (s. 78(2) & NP 47-601)
- g) NP 47-601 restrictions on the kind of radio and TV advertising that can be done during waiting period
- 4. file final prospectus
  - a) after this, receipt will (hopefully) be issued, usually only a day or two
  - b) executive director does have a public interest discretion, and can refuse a receipt where issuing a receipt would be against the public interest
    - (1) in the rules, it does talk about the executive directors discretion, which goes back to the "blue sky" or "merit" discretion - rule 120
    - (2) usually based on previous fraud, failure to comply in the past with securities regulations, belief that the amount seeking to be raised will not be enough for what the company wants to do with the money
- 5. post receipt:
  - a) sales can begin s. 61
  - b) must deliver prospectus s. 83(1)
    - (1) upon receiving an order for a security offered in a distribution, a dealer must send the purchaser a copy of the prospectus before, or within 2 business days of entering into the written confirmation to purchase the securities
  - c) two day cooling off period s. 83(2)
    - (1) a purchaser who has agreed to buy a security in a distribution has 2 business days from receiving the prospectus to back out of buying the security by giving notice of the intent not to be bound by the dealer from whom the security was purchased
  - d) electronic delivery permitted NP 11-201
    - (1) the recipient must receive notice that the document will be, or has been, sent electronically, or will be available electronically
    - (2) the recipient should have easy access to the document
    - (3) the delivered must have evidence that the document has been delivered or otherwise made available to the recipient
    - (4) the document received by the recipient must not be different from the document delivered or made available by the deliverer of the document

- e) amend prospectus to reflect "material changes NP 41-101, s. 6.6
  - (1) during the distribution period the prospectus must be amended to reflect any material changes
  - (2) the distribution of securities can last for up to 12 months from the date of receipt of the preliminary prospectus - after such period further distributions of the security cannot occur without renewing the prospectus
- 6. national offerings per NP 11-102 (passport system, except for Ontario) - note: in annotated statute this section is cited as NP 43-201 mutual reliance system
  - a) national policy 43-201 addresses complications/issues that could arise if an issuer had to respond to comments from 10 provinces and 3 territories
  - b) issuer files in all provinces where it wants to sell securities
  - c) a principal regulator is selected by the issuer based on where it's head office is located, or where it has the most substantial connection - this is who the issuer deals with, and the principal regulator will deal with the various provincial commissions
  - d) once principal regulator is satisfied that all materials have been filed, it will issue preliminary MRRS decision document to serve as receipt for preliminary prospectus
  - e) other jurisdictions will voice concerns to principal regulator, who will attempt to resolve with issuer on behalf of other jurisdictions
  - f) once all comments have been addressed, the principal regulator will issue a MRRS decision document that serves as the final receipt on behalf of all participating jurisdictions
- 7. US offering in Canada per NI 71-101
  - a) certain types of prospectus offerings by US issuers made in Canada can be made on the basis of disclosure compliance with the laws of the US, subject to the requirements of NI 71-101; the US has reciprocated with similar procedures for Canadian companies making offerings in the US
- **G. consequences of failure to file or deliver prospectus**
  - 1. failure to deliver a prospectus
    - a) penal sanctions: where the dealer fails to deliver a prospectus they may be exposed to a fine or imprisonment - BCSA s. 155(1)(a)
    - b) administrative sanctions - BCSA s. 161: failure to deliver a prospectus to purchasers could lead to sanctions imposed by the commission or administrator, such as an order directing compliance with the delivery obligation, and order that trading in the security ceases, cancellation or restriction of registration for trading, etc

- (1) this is where most of the issues are dealt with
- c) civil sanctions: where the prospectus is not delivered, the purchaser has a right of action for rescission or damages, subject to a limitation period - BCSA ss. 135(1), 140
- 2. failure to file the prospectus
  - a) penal sanctions: failing to file, or distributing a security without a receipt can lead to a fine or imprisonment - BCSA s. 155(1)
  - b) administrative sanctions: order that trading in the security cease until the prospectus is filed/receipt issued, can lead to denial of exemptions, an order that a person resign from a director or officer position of an issuer (if the issuer wants to remain trading as a public company), or lead to cancellation, suspension or restriction of a registrant's registration - BCSA ss. 161, 164
- (1) this is where most of the issues are dealt with
- c) civil sanctions:
  - (1) statutory: action for rescission or damages where a prospectus required to be delivered to a purchaser was either not sent or was not filed - BCSA s. 135(s), in conjunction with s. 83
  - (2) common law: purchaser may succeed in an action for declaration that the contract is void and be entitled to recover the price paid. the common law position may be slightly different in BC due to *Ames*, however the statute provisions now allow for civil action so the common law is not really needed in most cases anymore - see text page 129

### • **III. chapter 5: statutory liability & due diligence**

- **A. intro**
  - 1. statutory civil sanctions are now in place for misstatements or omissions
  - 2. sanctions expand upon the actions that would otherwise be available under common law - common law remedies are preserved through provincial securities acts, and are useful now once the limitation period has lapsed for a statutory remedy
  - 3. common law remedies are still very useful now in a couple situations:
    - a) where one wants to claim contractual warranty to get expectation damages
    - b) where the limitation period specified for the statutory remedy was lapsed
    - c) where the distribution period is very short and an investor has purchased the securities right away, but still outside of the distribution period, the only remedies available to them will be under common law

- **B. common law remedies/position**
  - 1. innocent misrepresentation
    - a) plaintiff must show: a material false representation; made to induce the plaintiff to enter into the contract; and that the plaintiff did enter into the contract
    - b) reliance is presumed
    - c) no defense to say error could have been discovered through careful investigation by plaintiff
    - d) defense would be showing plaintiff knew the actual facts, or that the plaintiff stated or showed through conduct that s/he did not rely on the misrepresentation
    - e) rescission but no damages
  - 2. contractual warranty
    - a) buyer must establish the misrep was intended to form part of contract at time of sale of security
    - b) misrepresentation was made; in the course of the sale of the security, for the purpose of inducing the purchase of the security, and actually did induce the purchase
    - c) damages awarded
  - 3. fraud:
    - a) plaintiff must show: the defendant knew or ought to have known that the plaintiff would rely, the plaintiff did rely to his/her detriment on the statement, the statement was made either knowingly or without belief in its truth, or recklessly/careless whether it be true or false
  - 4. negligent misrepresentation:
    - a) *Queen v. Cognos* gives elements for claim of negligent misrep:
      - (1) *duty*: must be duty of care based on "special relationship" between representor and representee: 2 steps - see page 154
        - i) in determining whether or not a duty exists, courts will consider skill of representor, skill of representee, and nature of occasion in which the representation was made - see text page 154
      - (2) *misrepresentation*: the representation in question must be untrue, inaccurate or misleading
      - (3) *negligence*: representor must have acted negligently in making the misrepresentation
      - (4) *reliance*: representee reasonably relied on the misrepresentation

- (5) *causation*: reliance was detrimental in the sense that damages resulted
- **C. statutory/civil liability**
  - 1. s. 131 expands common law liability for neg misrep:
    - a) removes plaintiff's need to prove: duty, negligence, reliance, causation
    - b) sets out list of persons that automatically owe a duty
    - c) expressly applies to misstatements or omissions
    - d) questions of reliance, negligence and causation are made into defenses
  - 2. now plaintiff only needs to show (s. 131(1)):
    - a) a purchase of the security offered under the prospectus
    - b) made during the period of the distribution
    - c) there was a misrepresentation in the prospectus
      - (1) misrepresentation: an untrue statement of a material fact or an omission of a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances
        - i) ex. stating that the issuer holds a patent, but neglects to say that the patent is being challenged by litigation
        - ii) ex. stating that profits have averaged \$4million per year for the last 10 years, but doesn't say that they had \$40million profit 10 years ago, and for the last 9 years profits have been \$0
      - (2) forecasts can be the subject of a misrepresentation, but there is no presumption that they do - this will be a question of fact - *Kerr v. Danier Leather*
    - d) s. 131(1)(a): plaintiffs are deemed to have relied on the misrepresentation if it was a misrepresentation at the time of purchase
  - 3. persons liable for damages in a misrepresentation in a prospectus:
    - a) the issuer (or the selling security holder if it is a distribution from the holding of a control person) - remedy is rescission
    - b) the underwriters - remedy is rescission
    - c) the directors
    - d) an expert who consents to the use of their expert opinion in the prospectus
    - e) CEO, CFO, and anyone else who signed the prospectus
- **D. defenses**
  - 1. *non-reliance*: person who purchased the securities had knowledge of the misrepresentation s. 131(4)

- 2. *non-consent*: he or she did not consent to the filing of the prospectus or that consent was withdrawn, with reasonable general notice of the withdrawal and the reason for it, prior to the purchase of the securities by the purchasers. 131(5)(a)
- 3. *not my statement*: statement was not made by him/her and he/she had no reason to believe, and did not believe, that it was a misrepresentation s. 131(5)(c)
  - a) basically claiming that it was a statement that was part of a financial report, etc, that should be covered by the relevant "expert" (auditor, etc)
- 4. *non-causation*: the depreciation in the value of the security was not caused by the misrepresentation
- 5. *due diligence*: he/she conducted a reasonable investigation to provide reasonable grounds for belief that there was no misrepresentation and he/she did not believe that there had been a misrepresentation s. 131(6)
  - a) *BarChris*: see text page 163
    - (1) bowling alley construction, many built on credit, market becomes oversaturated and BarChris runs into financial difficulty
    - (2) issue set of debentures with a prospectus that contained several misreps
    - (3) what constitutes a 'reasonable investigation' and a 'reasonable ground to believe' for the purposes of the defense will vary with the degree of involvement by the individual, his expertise, and his access to the pertinent information and data
    - (4) simply relying on the word of management, or on legal counsel, is not enough to satisfy due diligence
  - b) *Feit v. LeaseCo*: see text page 168
    - (1) involved takeover of RI by LeaseCo, where shares in RI were swapped for LeaseCo shares
    - (2) registration statement omitted information - may have caused RI shareholders to not realise the full value of the RI shares they were giving up for LeaseCo shares
    - (3) what is reasonable for one director may not be reasonable for another by virtue of their differing positions - inside directors might be held to a higher standard than outside directors
  - c) *Kerr v. Danier Leather* : see text page 169
    - (1) due to unseasonably warm weather, forecasted 4th quarter earnings lower than anticipated, CEO/CFO decided not to disclose this until after the end of the distribution period - although ultimately DL ended up coming in close to original forecasted numbers

- (2) at the time, all that had to be disclosed was material changes, not material facts - change in intra-quarterly results was not material change
- (3) the business judgment rule should not be used to qualify or undermine the duty of disclosure - the disclosure requirements of the Act are not to be subordinated to the exercise of business judgment
- (4) note: in BC, AB, ON & Sask adopted civil liability for misrepresentation in continuous disclosure documents, which means that now if listed on a stock exchange, material changes as well as material facts must be disclosed during the distribution period - s. 138
  - i) this means that when aware of a change in a material fact, and if listed on an exchange, companies would at the least have to issue a press release to notify of the change
- d) *YBM Magnex International*: see text page 174
  - (1) YBM suspected of ties to organized crime in Eastern Europe, and was being investigation; YBM set up a special committee consisting of outside directors to see what was going on with the investigation
  - (2) issues prospectus mentioning risks of doing business in Eastern Europe and existance of special committee - but didn't make any specific statements about organized crime or the committee mandate/findings
  - (3) OSC makes several comments on due diligence - see page 174-175
- 6. issuers defenses:
  - a) issuer is not entitled to the defenses of due diligence, or the defense that the statement was not made by the issuer s. 131(8)
  - b) issuer is subject to strict liability: only available defenses are that purchase had knowledge or the information, or that the depreciation in the value was not caused by the mispresentation
- 7. defenses for directors, underwriters and persons signing the prospectus:
  - a) can claim all 5 of the widely accepted defenses
  - b) with respect to the claim that statement constituting the misrep was not made by the defendant relates to parts of the prospectus purporting to be made on authoirty of an expert, an "official person" or an extract from a "public official document" s. 131(5)(c)
  - c) with respect to the claim that representation made on authority of an expert, defendant must not have had a belief, and must not have had reasonable grounds for a belief, that there had been a misrep, or, that that part of the prospectus did not fairly represent, or was not a fair representation or extract from the experts report s. 131(5)(c)

- d) with respect to statements made by an official person or in an extract from a public official document, defendant must show a belief, on reasonable grounds, that it was correct and fair representation of the statement, or copy of, or extract from the document
- e) with respect to statements not made on authority of an expert, by an official person or in an official document, the defence available to directors, underwriters and persons signing the prospectus is the defense of due diligence
- 8. experts defenses:
  - a) can claim all 5 defenses
  - b) with respect to statements made on authority of expert, expert can argue that it was not their statement - can be done by arguing that the misrep in the prospectus was due to a failure to fairly represent the experts report or opinion
    - (1) expert must have believed, on reasonable grounds, that their opinion or report was fairly represented (ie made a reasonable investigation)
    - (2) expert must have advised administrator or and given reasonable general notice of the misrep as soon as practicable after becoming aware of it
- 9. damages:
  - a) where claimed under statute, limited to the price at which the securities were offered to the public
  - b) in claims against underwriter, underwriter is not liable for more than the total public offering price represented by the portion of the distribution underwritten by that underwriter
  - c) liability of persons under statute liability is joint and several
- 10. limitation period and common law rights
  - a) statutory/civil sanctions are in addition to common law rights - this preserves common law rights of action which may be of value given the limitation periods on exercising statutory claims
- **E. the role of the securities lawyer**
  - 1. the comments made in YBM by the OSC on due diligence is a useful starting point for what to advise a client, as you start helping to prepare a prospectus
  - 2. see text page 176
- **IV. chapter 6: continuous disclosure**
  - **A. applies to reporting issuers s. 1(1) BCSA definition**

- 1. defined based on where the securities are sold: separates out closed market (people who do not need to know - large institutions & banks) and open market (people who need to know - individuals with less sophistication)
- 2. if trading on closed market, one is not a reporting issuer and therefore does not need to issue a prospectus or provide continuous disclosure
- 3. if someone in the closed market, like a bank, decides to sell securities that initially didn't have a prospectus, now the issuer is required to provide a prospectus, unless they can find another exemption
- 4. key feature of definition of reporting issuer: it is an issuer that has issued securities under a prospectus in the province, and also includes issuers who have securities listed and posted on a securities exchange in the jurisdiction
- **B. continuous disclosure of financial statements**
  - 1. annual:
    - a) must file annual financial statements within specified time (NI 51-201 given different times for venture (not on exchange) and non-venture (listed on an exchange))
    - b) must file balance sheet, income statement, statement of RE, cash flow statement and comparative statements for previous years
    - c) must be audited & approved by board or audit committee of the board
  - 2. interim:
    - a) to be prepared for interim periods of 3, 6, 9 & 12 months after the end of the previous financial year and must be filed within a specific amount of time following end of interim period - see s. 1.1, 4.3, 4.4 of NI 51-102
    - b) must include income statement, statement of RE, cash flow statement covering beginning of fiscal year to particular interim period, comparative info from corresponding period from previous year
    - c) interim statements do not need to be audited, but it is common to have them reviewed by an auditor
    - d) if not reviewed by an auditor, statements must include a note stating that
    - e) if an auditor started but could not complete the review, a report stating reasons why must accompany the statements
    - f) if an auditor expresses reservation on the statements, a written review report must be provided where the reservation is expressed
  - 3. delivery of financial statements
    - a) registered and beneficial owners of a security (other than debt instruments) must once a year receive a request form that allows them to request a copy of the annual and interim financial statements - NI 52-102 s. 4.6

- 4. statements must be prepared according to GAAP
  - a) acceptable GAAP for Canadian, US and foreign issuers - see NI 52-107
  - b) part 5 NI 52-107 gives exceptions for when a US or foreign company is not required to comply with Canadian GAAP
- 5. audit by auditor subject to auditor oversight
  - a) NI 52-108 - the auditor must be a public accounting firm that has entered into a written agreement with the Canadian Public Accountability Board
- 6. exemptions from financial disclosure requirement: BC Rule 3(7)
  - a) general:
    - (1) NI 51-102 s. 13.1: general exemption provision, regulator or securities regulatory can grant an exemption from NI 51-102 subject to terms and conditions that it imposes
    - (2) exemptions can be made where doing so isn't contrary to public interest
  - b) deviation from GAAP:
    - (1) deviation/exemption granted where it is not reasonably practicable for the issuer to revise the presentation of the financial statement to conform, where the deviation is supported/justified by considerations that outweigh the desirability of uniform adherence to GAAP, where the deviation would not be prejudicial to the public interest
    - (2) NI 52-107 also provides exemption in Part 9
  - c) conflict of laws or another jurisdiction:
    - (1) exemption provided where the reporting requirements of the incorporating or organizing jurisdiction conflict with the requirements of another provinces securities act
  - d) specific omissions from disclosure:
    - (1) exemption for comparative figures where the issuer changes its year and and the calculation of comparative figures would be difficult or unlikely to yield useful comparisons
    - (2) exemption for disclosure of sales or gross operating revenue where the disclosure of such information would be unduly detrimental to the interests of the reporting issuer
  - e) consistency of reporting:
    - (1) where information is disclosed by the reporting issuer in a different form or at different times than required by the applicable provincial act
- C. **continuous disclosure of MD&A 51-102F1 part 1, CP 51-102**

- 1. MD&A provides narrative explanation from perspective of management of how the reporting issuer performed during the financial year or interim period to which the MD&A relates
- 2. purpose of MD&A is to improve overall disclosure by providing balanced discussion of the issuers results, including considerations such as liquidity, capital resources, and openly reporting both good & bad news
- 3. MD&A is where issuer will report material information that cannot be reflected in the financial statements, such as contingent liabilities, defaults on debt, off-balance sheet financing, and other contractual obligations
- 4. should reflect trends and risks that have affected, and/or are reasonably likely going to affect, the financial statements
- 5. must provide information about quality and potential viability of the issuer's earnings and cash flow to assist investors in determining of part performance is indicative of future performance, with a focus on material information
- 6. MD&S has a forward-looking character (Form 51-102F1, Part 1, para (g)):
  - a) discussion of known trends or uncertainties reasonably likely to affect the business
  - b) issuer is encouraged to provide general forward looking information that has a reasonable basis
- 7. must disclose info on outstanding voting or equity securities
  - a) designation & number or principal amount of each class and series of voting or equity securities, that are convertible into or exercisable or exchangeable for voting or equity securities, or that are issuable on the conversion, exercise or exchange of outstanding securities of the issuer
- 8. interim MD&A: Form 51-102FI, Part 2
  - a) intended to update issuers annual MD&A
- 9. the annual/interim MD&A is filed with corresponding financial reports
- 10. must be approved by board of directors or the audit committee of the board
- 11. request form sent to investors allowing them to request financial statements (discussed above (NI 51-102)) must also allow an investor to request the corresponding MD&A - the requested MD&A must be sent by the later of the filing deadline for the MD&A or 10 days after the receipt of the request
- **D. continuous disclosure in annual information form Form 51-102F2**
  - 1. reporting issuers, with exception of venture issuer, must file an AIF
  - 2. AIF draws information about the business (from the prospectus), interim and annual financial statements, and material information reports together on an

annual basis to provide information about the issuer and its business at the end of the most recently completed financial year

- 3. AIF describes the issuer, its operations and prospects, and notes risks and other external factors that impact the issuer
- 4. must be filed no or before the 90th day after the end of the financial year
- 5. focus is on material information that would likely change or influence an investor's decisions whether or not to buy, sell or hold the securities if the information was omitted or misstated
- 6. may incorporate information by reference to info contained in another document other than a previous AIF
  - a) if that document has not previously been filed, it must be filed at the same time as to AIF which refers to it
- **E. proxy/information circulars**
  - 1. see text page 194
  - 2. form of proxy: a document that gives a person named therein the power to exercise the vote of the person who signs the form of proxy - the proxy holder must exercise the vote in the manner indicated in the form of proxy
  - 3. corporations will use form of proxies to solicit proxies from shareholders, to ensure that sufficient shares would be represented at the shareholders meeting to ensure that the business of the meeting would be completed
  - 4. proxy solicitation requirements: NI 51-102
    - a) must indicate whether or not it is solicited on behalf of management, and allow security holder to appoint as proxyholder someone other than the person designated by management
    - b) must allow security to vote for or against each matter set out other than the appointment of auditor and election of directors
    - c) for appointment of auditors and election of directors, proxy must provide option for security holder to specify that the securities be voted or withheld from voting
    - d) every person who solicits proxies must also send an information circular
  - 5. information circular requirements: Form 51-102F5
    - a) interests of persons making a solicitation in the matters to be voted upon
    - b) where known by directors/officers of the issuer, names and holdings of persons having direct/indirect beneficial ownership of >10% voting rights
    - c) information about persons proposed as directors
    - d) corporate governance disclosure: NI 58-101 & Form 58-101F1

- (1) if management solicits a proxy from shareholders for purpose of electing directors , it must include certain specified disclosure on corporate governance
- (2) if not soliciting a proxy for electing directors to the board, information on corporate governance must be included in the AIF
- (3) NP 58-201 - CSA gives guidelines on corporate governance
- e) details of executive compensation: From 51-102F6
  - (1) must cover CEO, CFO, & 3 most highly compensated executives other than CEO & CFO who were serving as executive officers at the end of the most recently completed financial year and whose bonus & salary exceeded \$150K
  - (2) also must disclose compensation of directors, compensation committee, and the policies of the compensation committee, or board of directors, during the most recently completed financial year
- f) information regarding compensation plans under which equity securities of the issuer are authorized for issuance
- g) indebtedness of directors/exec senior officers to the issuer/subsidiaries
- h) interests of insiders on material transactions
- i) details of mgmt contracts under which a substantial degree of mgmt functions are performed by persons other than directors/exec officers
- j) details on matters to be voted on in enough detail to permit security holders to form a reasoned judgment concerning the matter
- k) written in plain language
- l) can incorporate by reference other documents so long as they were previously filed, or are filed with the information circular
- 6. exemptions from proxy & information circular requirements
  - a) automatic exemptions:
    - (1) de minimus 15 shareholder test: where there are 15 or fewer security holders, management does not need to comply with requirement to send information circular: NI 51-102 s. 9.2(b)
    - (2) compliance with another jurisdiction: where issuer has complied with laws of another jurisdiction, exempt from proxy solicitation and information circular requirements: NI 51-102 s. 9.5, BCSA 119(1)
    - (3) registrants forwarding meeting materials: where brokers/nominees hold securities on the behalf of others, they are considered to be performing a task that was not intended to influence the vote of the security holders NI 54-101 s. 4.2, BC Rule 182(2)

- (4) requests by beneficial owners of execution of proxy by registered holders: where a beneficial owner requests that the registered holder execute a form of proxy, they are exempt because the request for the form of proxy does not influence anyone NI 51-102 s. 9.2(1)
- b) discretionary exemptions:
  - (1) where laws of incorporating or organizing jurisdiction conflict with the particular securities act BCSA s. 119(2)
  - (2) other adequate justification: situations such as cost/benefit of complying - commission will consider # of security holders affected, proportion of securities held in the particular province compared to total number outstanding, other forms of disclosure, degree of complexity of issues to be decided upon at meeting BCSA s. 119(2)(b)
- 7. NI 54-101
  - a) addressed problem where a large majority of securities may be held by a depository institution as the registered holder, but the beneficial holder of the security, who is entitled to exercise the voting rights, is someone else
  - b) NI 54-101 creates system for the issuer to communicate with the beneficial owner of the securities
- **F. certification of financial statements by CEO & CFO**
  - 1. certification must be filed with annual financial statements/MD&A, or with the AIF
  - 2. annual certificate requires officers to certify:
    - a) that the filings do not contain untrue statements of material fact, omit to state a material fact
    - b) that based on their knowledge the annual financial statement together with the other financial information included fairly represent all material aspects of financial condition, etc
- **G. business acquisition reports**
  - 1. NI 51-102 - issuer must file business acquisition report within 75 days of completing a significant acquisition
  - 2. report describes the significant business acquired by the issuer, and the effect of the acquisition on the issuer. describes the nature of the business acquired, the date of acquisition, the consideration paid/payable by the reporting issuer in connection with the acquisition, source of funds for the acquisition, plans/proposals for material changes in the business affairs of the reporting issuer that may affect the issuer financially/operationally, stock valuations of acquired company for past 12 months
  - 3. tests for significant acquisitions: asset test, investment test, income test

- a) asset test: acquired businesses assets exceed 20% of the assets of the reporting issuer
- b) investment test: consolidated investments in and advances to the acquired business as at the date of the acquisition exceeds 20% of the consolidated assets of the issuer as of last day of most recent completed financial year
- c) income test: reporting issuer's proportionate share of consolidated income from operations of the acquired business exceeds 20% of the consolidated income from operations of the reporting issuer
- **H. insider reports**
  - 1. BCSA s. 87(2), BC Reg s. 155.1: insider required to file reports of ownership and trading in securities of issuer, and are required to file insider reports within 10 days of becoming an insider
    - a) must disclose any direct or indirect beneficial ownership of, control or direction over, securities of reporting issuer - also must disclose when this situation changes
  - 2. insider defined to include:
    - a) directors/senior officers of issuer & persons having direct/indirect beneficial ownership of, or control or direction over, securities of the issuer carrying more than 10% of the voting rights attached to all the issuers outstanding voting securities
    - b) directors/senior officers of subsidiaries or of any person that is an insider by virtue of having direct or indirect beneficial ownership of, or control or direction over, securities of the issuer carrying more than 10% voting rights attached to the issuers outstanding voting securities
    - c) includes the issuer when it holds its own shares
    - d) directors/officers deemed to be insiders of other issuers in certain circumstances:
      - (1) where issuer becomes an insider of reporting issuer
      - (2) where a reporting issuer becomes an insider of another reporting issuer
- **I. timely disclosure:**
  - 1. material information reporting requirements:
    - a) reporting of "material changes": NI 51-102 & BCSA s. 85
      - (1) must disclose material changes in affairs of reporting issuer by: filing press release as soon as practicable that discloses the nature/substance of change, and filing report of the material change as soon as practicable and within 10 days
    - (2) material change defined: BCSA s. 1(1)

- i) a change in the business, operations or capital of the issuer that would be reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer
- ii) includes a decision to implement a change made by either the directors, or by the senior managers of the issuer where they believe that the directors will likely confirm the decisions
- iii) TSX also has special rules with respect to the disclosure of "material information" for those listed on the TSX
- b) extension to material facts
  - (1) material fact defined: BCSA s. 1(1):
    - i) a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of the reporting issuer's securities
    - ii) different from "change" in that it is not directly related to the "business, operations, assets or ownership of the issuer"
    - iii) ex: change in value of assets could be a material fact, whereas a change in the assets themselves could be a material change
  - (2) securities legislation in Canada only required disclosure of material changes, not material facts
  - (3) through NP 510102, Canadian Securities Administrators sought to extend timely disclosure requirements to material facts
- c) *Pezim v. British Columbia (Superintendent of Brokers)*
  - (1) mining company failed to disclose results of allegedly very significant series of assay results
  - (2) BCCA ruled that BCSA only refers to material changes, not material facts, leg could have extended to material facts if they wanted to
  - (3) commissions may not amend securities acts through national policies
  - (4) SCC overturned: while commissions do not have right to overrule securities legislation, they should be given considerable deference in determining what constitutes a material change, this goes to the heart of commissions purpose to regulate securities markets in public interest
  - (5) found that once explored, a piece of land (asset) did change itself, because it became either a "moose pasture or ore" - the nature of the land (asset) changed based on the exploration results
- d) what must be reported (IE what is material): NP 51-201 disclosure standards

- (1) TSX and TSX Venture policies, which require timely disclosure of material info (which includes material changes and material facts)
- (2) exchange policy requirements exceed those imposed by securities legislation: issuers that don't comply with exchange requirements could be subject to administrative proceedings before provincial securities regulator
- (3) provides guidance on making judgment as to materiality for the purpose of complying with timely disclosure - see text page 215-216 for events that might be material
- (4) issuers not normally required to interpret impact of external political, economic and social developments on their affairs, but should explain an external development if it will have, or has had, a direct effect on the business and affairs of the issuer that is both material and uncharacteristic of the effect experienced by other issuers in the same business or industry
- 2. proposed changes, detrimental information and confidential reporting
  - a) issuer may report material information on a confidential basis to the commission, and where it can do this no press release is required, but every 10 days the issuer must advise the commission in writing if it believes the information should be kept confidential
  - b) may be done where:
    - (1) unduly detrimental: NI 51-102 s. 7.1(2)(a), BCSA s. 89(2) - the reporting issuer is of the opinion that the disclosure would be unduly detrimental to the interests of the reporting issuer
      - i) NP 51-201 - confidential disclosure may be permitted where disclosure might interfere with the issuer's pursuit of a specific objective or strategy, with ongoing negotiations, or with its ability to complete a transaction
      - ii) weighs possible gains & losses from disclosing
    - (2) proposed changes: NI 51-102 - the material changes involves a decision to implement a change made by senior management who believes that confirmation of the decision by the board is probable, and senior management has no reason to believe that persons with knowledge of the material change have made use of such knowledge in purchasing or selling the securities of the issuer (removes insider trading issue)
      - i) takes into consideration concern that if the change is not in fact implemented, and/or if a substantial number of disclosures turn out to be incorrect, the reliability of disclosure could be reduced

- **J. process of disclosure**
  - 1. NP 51-201 provides several best disclosure practices: see text page 220
- **K. multi-jurisdictional disclosure system**
  - 1. NI 71-101 sets out multi-jurisdictional disclosure system that implements an agreement with the SEC in the US under which US issuers can meet Canadian securities requirements and meeting other conditions set out in the instrument
- **L. system for electronic document analysis & retrieval (SEDAR)**
  - 1. several commissions require that documents be filed electronically through SEDAR, unless an issuer is foreign or exempted from the requirement
- **M. sanctions with respect to continuous disclosure requirements**
  - 1. see page 225-237 - note much of this doesn't apply in BC
  - 2. statutory sanctions:
    - a) penal sanctions (BCSA ss. 155, 155(1)(b), s. 168.1) for failing to comply with continuous disclosure requirements, or for misrepresentations in the required disclosure documents
    - b) compliance orders (BCSA ss. 157, 161(1)(a))
    - c) cease trade order (BCSA ss. 161(1)(b), 146)
    - d) removal of issuers right to use various exemptions as provided in Act (BCSA s. 161(1)(c))
  - 3. statutory civil liability:
    - a) see previous notes on statutory liability for failure to disclose
    - b) no BCSA sections are mentioned here - likely this does not apply in BC, but would in Ontario, Alberta and Manitoba
- **V. chapter 7: exemptions from the prospectus requirement**
  - **A. concept of the closed system**
    - 1. securities only be allowed to trade outside of this closed secondary market if that trading is supported by adequate continuous disclosure
    - 2. where an person purchases securities under an exemption, there are 3 different options for selling the securities
      - a) trade within the closed market:
        - (1) exemption will be available only where the purchasers are persons who do not need to know the information contained in the prospectus
      - b) trade outside of the closed market: method 1- reporting issuer
        - (1) can occur where the issuer becomes a reporting issuer and provides a prospectus and subsequent continuous disclosure documents

- c) trade outside closed market: method 2 - resale restrictions NI 45-102
  - (1) deemed distribution: restriction on resale of securities purchased under an exemption is effected by deeming such a resale to be a distribution, making such a resale subject to prospectus requirement, unless one of 2 sets of conditions are met under either s. 2.3 or s. 2.4
  - (2) resale restrictions allow person who purchased under an exemption to sell to members of the investing public so long as conditions have been met to ensure adequate continuous disclosure has been met
  - (3) these rules in place to prevent backdoor underwriting
- **B. resale restrictions per NI 45-102 ss. 2.3/2.5: distributions under appendix D**
  - 1. these rules apply to the following types of trades/classes of traders (app D)
    - a) accredited investors: NI 45-106 s. 2.3
      - (1) several exempt institutions listed under definition in NI 45-106 s. 1.1
      - (2) main exemption for private placements, on basis that these are investors with high degree of knowledge and skill
      - (3) only applies where investor is purchasing as principal, not as agent or trustee for accounts it manages
        - i) but will apply for trust companies/portfolio managers, where investor not purchasing as principal, because it is presumed they are purchasing with intent to invest on behalf of clients
      - (4) includes: registered dealers & advisors, banks/financial institutions/trust companies, investment accounts managed by trust companies or portfolio managers, investment funds, registered charities, persons with significant income/wealth, persons owned by accredited investors
    - b) family, friends and business associates: NI 45-106 s. 2.5
      - (1) similar to private issuer exemption (see below, exemption is under the next set of resale rules per NI 450102 ss. 2.4/2.6)
    - c) affiliates: NI 45-106 s. 2.8
      - (1) distribution of a security by an issuer to an affiliate
      - (2) issuer is an affiliate of another if one of the issuers is the subsidiary of the other or if each is controlled by the same person
    - d) offering memorandum: NI 45-106 s. 2.9
      - (1) applies where there is a trade by an issuer in a security of its own issue to a person if the purchaser purchases the security as principal and before/while signing purchase agreement the issuer delivers an offering memorandum to the purchase and the purchaser signs a risk acknowledgement

- e) minimum amount investment: NI 45-106 s. 2.10
  - (1) where the cost to the purchaser is not less than \$150K paid in cash at time of purchase, and purchaser is purchasing as principal
- f) asset acquisitions: NI 45-106 s. 2.12
  - (1) where transaction involves purchase of securities in exchange for assets of investor, and fmV of assets is not less than \$150K
- g) petroleum, gas, mining properties: NI 45-106 s. 2.13
- h) securities for debt: NI 45-106 s. 2.14
  - (1) where securities are issued by reporting issuer in a security of its own issue to a creditor to settle a debt of the reporting issuer
- i) additional investment in investment fund: NI 45-106 s. 2.19
  - (1) where purchaser is one who made initial purchase of securities of the fund as principal for a cost of not less than \$150K, the securities being distributed are of the same class/series as those in the initial trade, and at the date of distribution the purchaser holds securities for the fund having acquisition cost/net asset value of no less than \$150K
- j) isolated trades: NI 45-106 s. 2.30
  - (1) one time trades that would not qualify under one of the other exemptions, where the value is under \$150K, purchased by a person who is not in business of trading securities - the cost of the prospectus would not justify the small amount of investment
- k) TSX venture offering document: NI 45-601 ss. 5.1 & 5.2
  - (1) where the purchaser was an insider, promoter, underwriter or member of underwriter's professional group, for the issuer, or the purchaser purchases securities in excess of \$40k
- 2. a trade will not be a distribution/require a prospectus where:
  - a) issuer has been reporting issuer in Canada for 4 months preceding trade
    - (1) ie providing continuous disclosure through financial statements etc
  - b) 4 months since distribution date has elapsed (restricted period)
  - c) legend: security certificate or ownership statement contains a legend indicating the period during which the securities can't be sold
  - d) trade is not a control distribution
  - e) no unusual effort is made to prepare the market/create demand
    - (1) trade made on basis of available info, not on reps/promotions
  - f) no extraordinary commission/consideration is paid to a person/company in respect of the trade

- g) if seller is insider/officer of the issuer, they have no reasonable grounds to believe the issuer is in default of securities legislation
- (1) ie hasn't filed AIF, other disclosure documents
- h) with the exception of affiliates (2.8), s. 6.1 NI 45-106 requires the trade be reported within 10 days of the distribution
- **C. resale restrictions per NI 45-102 ss. 2.4/2.6: specified under appendix E**
  - 1. resale rules apply to the following types of trades/classes of traders (app E)
    - a) rights offering: NI 45-106 s. 2.1
      - (1) written notice must be given to relevant securities regulators stating date, amount, nature and conditions of the trade, including approx net proceeds to be derived by the issuer if the securities subject to the rights offering are fully taken up
      - (2) must wait 10 days after written notice to see if any regulators object - if they do, additional info must be provided to satisfy concerns
    - b) reinvestment plan: NI 45-106 s. 2.2
      - (1) where dividends or distributions of earnings payable to an investor are applied to purchase of securities of same class/series as the securities to which the dividends/distributions are attributable
      - (2) purchase must be directed by the investor, not the issuer
      - (3) issuer must give same reinvestment option to every security holder in Canada to which dividends/distributions are available
    - c) private issuer: NI 45-106 s. 2.4
      - (1) not a reporting issuer, securities are subject to transfer restrictions contained in constituting documents/security holder agreement, securities beneficially owned by not more than 50 persons, issuer has distributed securities only to the exempt purchaser
      - (2) purchase must be purchasing as principal and is an exempt purchaser:
        - i) director, officer, employee, founder, control person of issuer
        - ii) also extends to family and friends of people above - see s. 2.4(2)
      - (3) exemption applies to persons who are "not the public" (text 240)
        - i) *Ralston Purina*: "to the public" applies whether the offer is made to many persons or to only a few persons - key question is whether the persons need to know the info that the prospectus would provide
        - ii) *Peipgrass*: "not the public" refers people who are in a sense friends or associates of the issuer, or persons having common bonds of interest or association

- d) business combination or reorganization: NI 45-106 s. 2.11
  - (1) refers to amalgamations, mergers, reorganizations or arrangement where shares of issuer are being swapped for shares of another issuer
  - (2) info similar to info in prospectus is provided through information circular or other document
- e) takeover bid and issuer bid: NI 45-106 s. 2.16
  - (1) offeror has provided similar info to that in a prospectus to the takeover bid circular
- f) investment fund reinvestment: NI 45-106 s. 2.18
  - (1) (1) where dividends/distributions out of earnings in respect of the investment funds securities are applied by the investment fund investor to purchase of more securities of same class/series to which the distribution is attributable
  - (2) (2) also applies where fund investor makes optional cash payments to purchase securities of the fund that are of same class/series of the securities owned by the investor - limited to 2% of the issued and outstanding securities to which the optional cash purchase plan related in any financial year
- g) private investment club: NI 45-106 s. 2.20
  - (1) where an investment fund has no more than 50 beneficial security holders, does not seek/has never sought to borrow money from public, does not/has never distributed securities to the public, does not pay remunerations for investment management/admin advice in respect of trades in securities (except for broker fees), for purposes of financing the investors make contribution in proportion to the value of the securities held by them
- h) loan and trust pools: NI 45-106 s. 2.21
  - (1) where there is a fund which co-mingles money of different estates and trusts for purpose of facilitating investment on behalf of those trusts/estates - company must be registered/authorized to carry on loan/trust business in Canada
- i) current/former employee, executive officer, director, consultant: NI 45-106 ss. 2.24 - 2.26
  - (1) trades presumably based on common bonds
  - (2) this applies to reporting and non-reporting issuers
- j) dividends/distributions: NI 45-106 s. 2.31
  - (1) where paid out in the form of stock instead of cash

- 2. a trade will not be a distribution/require a prospectus where:
  - a) issuer has been reporting issuer in Canada for 4 months preceding trade
    - (1) ie providing continuous disclosure through financial statements, etc
  - b) trade is not a control distribution
  - c) no unusual effort is made to prepare the market/create demand
    - (1) trade made on basis of available info, not on reps/promotions
  - d) no extraordinary commission/consideration is paid to a person/company in respect of the trade
  - e) if seller is insider/officer of the issuer, they have no reasonable grounds to believe the issuer is in default of securities legislation
    - (1) ie hasn't filed AIF, other disclosure documents
- 3. where the resale is being made by a control person, the conditions in ss. 2.5 & 2.6 do not apply
- **D. other exemptions not subject to ss. 2.3/2.5 or 2.4/2.6 of NI 45-102**
  - 1. control block exemptions:
    - a) control person defined NI 45-106 s. 1(1): person who holds, or combo of persons acting in concert who hold sufficient voting rights attached to outstanding voting securities to materially affect the control of an issuer
    - b) deemed control person where person/group in concert holds >20% votes
    - c) prospectus not required so long as: resale rules in NI 45-102 s. 2.8 apply
      - (1) issuer has been reporting issuer for at least 4 months
      - (2) control person selling has held them for at least 4 months
      - (3) no unusual effort made to prepare market/create demand
      - (4) no extraordinary commissions/consideration paid to a person/company in respect of the trade
      - (5) control person has no reasonable grounds to believe the issuer is in default of securities legislation
    - d) control person must file a form 7 days before the trade to make others aware
    - e) control person must file a report with respect to trade within 3 days of making the trade
  - 2. issuer acquisition or redemption: NI 45-106 s. 2.15
    - a) where issuer is purchasing securities of its own, because the seller and purchaser are the same person
  - 3. exemption orders: BCSA s. 76

- a) securities may grant exemption, where issuer doesn't fall under any of the other exemption categories, where it would not be against the public interest to give an exemption
- b) when exemption is granted, commissioner can impose terms/condition upon exemption, and will often provide resale restrictions similar to those in NI 45-102
- 4. underwriters when involved in production of prospectus - NI 45-106 s. 2.33
- 5. government issued or government guaranteed debt - NI 45-106 s. 2.34
- 6. short term debt - NI 45-106 s. 2.35
- 7. not for profit educational, benevolent, fraternal, charitable, religious or recreational purposes - NI 45-106 ss. 2.36(2), 2.38(1) & (3)
- 8. variable insurance contracts - NI 45-106 s. 2.39
- 9. mortgages - NI 45-106 s. 2.36
- 10. exercise of conversion, exchange or purchase rights - NI 45-102 s. 2.3 to 2.6, appendices D & E
- **E. reasons for exemption: expanded in policy outline**
  - 1. where cost of prospectus outweighs the benefits of the prospectus
  - 2. no need to know:
    - a) sophisticated investors: high degree of investment expertise
    - b) large purchases: in position to demand more info, size of investment gives investor incentive to obtain advice before purchasing
    - c) wealthy investors: likely sophisticated investors, have knowledge of managing investment portfolio, in better position to sustain a loss
    - d) common bonds: where the investor already knows much of the information that would be provided in the prospectus
  - 3. no new information:
    - a) rights offerings: investors already have info pertaining to the securities, may need to provide any relevant info unique to the rights offering
    - b) stocks dividends: info re securities has previously been disclosed or initial securities allowed exemption
    - c) takeover bids and amalgamations: similar information given through takeover bid circular, proxy circular and/or information circular
    - d) reinvestment plans: prospectus for original securities already outstanding, securities under these plans not issued to finance new business ventures
  - 4. safe investment: where security (ex. bonds) is tied more to person's ability to pay (ex government) than to info normally provided in prospectus

- 5. small number of investors and small monetary value
- 6. small business/venture capital: smaller infusions of capital, investors will often fit into a class of exemptions such as common bonds or sophisticated investor, in position to make demands to protect themselves
- 7. regulated under another regulatory regime: ex banks & financial institutions, insurance contracts - other vehicles in place to protect purchaser
- 8. reliance on efficient market: where there is sufficient following of the security so that the price reflects the underlying value of the security: public float test
  - a) sufficient following is determined by the "public float test": is the value of securities issued/outstanding enough to make it profitable/worthwhile for sophisticated investor to gather/assess available info on the securities
- 9. promotion of specific investments or activities: ex for particular activities like religious, charitable or educational activities, to encourage the activity and reduce the cost of funding such endeavours
- **VI. chapter 8: short form prospectus**
  - **A. short form prospectus NI 44-101**
    - 1. concept of short form prospectus
      - a) applies to eligible issuers that are reporting issuers and are already providing continuous disclosure documents
      - b) short form only contains information specific to new offering, reducing the amount of information that the commission needs to vet
      - c) allows eligible issuers to get new offerings of securities to market in a shorter period of time
      - d) reduces the risk of fluctuations in the market price between the time the issuer initially decides to make a new offering and the time the securities can be sold
    - 2. basic qualification criteria: NI 44-101 ss. 2.1 & 2.2
      - a) issuer is a reporting issuer in at least one jurisdiction in Canada and files its disclosure documents electronically
      - b) issuer has filed all required periodic and timely disclosure documents that it is required to file in each jurisdiction in which it is a reporting issuer
      - c) issuer has current annual financial statements and a current AIF
        - (1) current annual financial statements: see definition in NI 44-101 s. 1.1
        - (2) current AIF: see definition in HI 44-101 s. 1.1

- d) issuer's equity securities are listed and posted for trading on the TSX, tier 1 or tier 2 of the TSX Venture Exchange or the Canadian Trading and Quotation System
- e) issuer is not an issuer whose operations have ceased or whose principal capital asset is cash, cash equivalents (defined in NI 44-101 s. 1.1) or its exchange listing
- f) reasons for criteria:
  - (1) ensures there is up to date info on business that is available to investors
  - (2) listing requirements and electronic copies of disclosure documents reflected in price of securities, provide protection to investors
  - (3) ensures there is adequate build up of disclosure, some market following
- 3. alternative criteria for non-convertible securities NI 44-101 s. 2.3
  - a) applies where an issuer issues approved rating non-convertible securities
  - b) issuer must be a reporting issuer that files its disclosure documents electronically
  - c) issuer has filed all required periodic and timely disclosure documents that it is required to file in each jurisdiction in which it is a reporting issuer
  - d) issuer must have current AIF and current annual financial statements
  - e) instead of requirement to be listed on TSX, TSX Venture or CTQS, the securities to be distributed must have a provisional approved rating
  - f) issuer must not be aware of any reason why it would be downgraded to something less than an approved rating
  - g) issuer must not receive a final rating that is less than an approved rating
  - h) reasons for alternative criteria
    - (1) rating organization makes thorough assessment of issuer when rating
    - (2) rating provides a signal for how the securities should be priced
    - (3) approved ratings are presumable sufficient to protect against risks of default on the securities - issuer sufficiently sound
- 4. alternative criteria for issuers of guaranteed non-convertible debt securities, preferred shares and cash settled derivatives NI 44-101 s. 2.5
  - a) securities to be distributed must be given "full and unconditional credit support" by a "credit supporter"
    - (1) credit supporter: person/company which provides guarantee/alt credit support for payments to be made on the issuer's securities
    - (2) alternative credit support: support, other than a guarantee, to assure the investor receives payment from another if the issuer defaults

- (3) full and unconditional credit support: alternative credit support that results in the issuer having the same or higher credit rating, or a guarantee of payments from the guarantor
- b) credit supporter must meet the basic qualification criteria, but instead of being listed on an exchange it may have an approved rating
- c) reasons for alternative criteria:
  - (1) does not require issuer to provide up to date information, because the issuer is ultimately not responsible for payment
  - (2) the ultimate risk is usually a default by the guarantor/alternative credit supporter
  - (3) requirement to be listed or have approved rating ensures some sort of market following and/or close analysis of disclosure documents to reduce risk
- 5. alternative criteria for issuer of guaranteed convertible debt securities or preferred shares NI 44-101 s. 2.6
  - a) debt securities or preferred shares must be convertible into securities of a credit supporter and the credit supporter has provided full and unconditional credit support
  - b) the credit supporter must meet the basic qualification criteria
  - c) no requirements for issuer to have market following/up to date info
  - d) reasons for alternative criteria
    - (1) payment obligations depend on creditworthiness of credit supporter, so information about the credit supporter needs to be provided
- 6. alternative qualification criteria for issuer of asset-backed securities NI 44-101 s. 2.6
  - a) issuer must file electronically on SEDAR
  - b) must have current annual financial statements, AIF
  - c) ABS's to be distributed have received approved provisional rating
  - d) ABS's to be distributed must not be subject of any announcement, of which issuer is or reasonably ought to be aware, that the approved rating might be downgraded to something less than an approved rating
  - e) ABS's must not receive provisional/final rating of less than approved rating
  - f) reasons for alternative criteria:
    - (1) up to date information on issuer is provided
    - (2) issuer may not meet market following requirement, but this is replaced by an examination of the issuer and the ABS's by an approved rating

- **B. short form prospectus form and content: NI 44-101 and Form 44-101F1**
  - 1. includes information mainly about the particular securities being offered:
    - a) use of proceeds of the issue
    - b) plan for distribution
    - c) whether there will be a market for the securities
    - d) details about the characteristics or rights attached to the securities
    - e) other material facts relating to the issue
  - 2. does not include some information required in long form prospectus:
    - a) extended disclosure of issuer's corporate structure
    - b) general development of the business (including 3-year history and narrative on business)
    - c) financial information and MD&A
    - d) disclosure concerning directors/officers and their compensation
    - e) most of this will be incorporated by reference
  - 3. materials that must be incorporated by reference: NI 44-101 s. 3.1
    - a) issuer's current AIF & financial statements (includes MD&A)
    - b) must recently files interim financial statements
    - c) other financial information publicly disseminated by the issuer through news release or otherwise
    - d) material change reports (unless confidential)
    - e) any business acquisition report filed by the issuer
    - f) any information circular filed by the issuer
    - g) statements made in continuous disclosure documents once incorporated by reference are subject of civil liability for misreps in the prospectus to the extent the comments have not been superceded by statements in subsequent disclosure documents
  - 4. solicitations of interest that would constitute acts in furtherance of a trade
    - a) only allowed where the issuer has entered into an enforceable agreement with an underwriter who has agreed to purchase the securities on fixed terms that require the issuer to file a preliminary prospectus not more than four business days after the date of the agreement and the issuer has issued and filed a news release announcing the agreement immediately upon entering into the agreement NI 44-101 s. 7(1)(a)-(c)
  - 5. non-fixed price offerings
    - a) generally the price for the securities is set in the prospectus

- b) price does not need to be fixed where securities are distributed for cash and have a provisional or final approved rating from at least one approved rating organization
- **C. shelf offering prospectus**
  - 1. concept & process:
    - a) allows an issuer to qualify securities in advance for multiple subsequent distributions to the public over a specified future period
      - (1) the initial shelf prospectus does not contain any information on a particular offering - this is done on issuance
    - b) when they go to do an issuance, they file a supplemented shelf prospectus that will detail:
      - (1) the amount of proceeds
      - (2) use of proceeds
      - (3) plan of distribution (ie bought deal, marketed offering, etc)
    - c) the commission will vet the initial shelf prospectus, and then when the issuance goes out, the supplemented shelf prospectus does not need to be vetted
    - d) the supplemented shelf prospectus needs to be released within 2 days of the start of distribution
  - 2. eligibility: NI 44-102 Part 2
    - a) issuer must satisfy one of the sets of criteria for the short form prospectus
    - b) any distribution that may be done under a short form prospectus, other than a rights offering, maybe done using the shelf prospectus procedures
    - c) an issuer can use the shelf offering prospectus if it has received an exemption order from a securities regulatory authority
  - 3. disclosure procedures:
    - a) due to eligibility requirements, there will either be continuous disclosure of the issuer, or of the person guaranteeing the securities
    - b) the base shelf prospectus NI 44-102 s. 5
      - (1) issuer must file base shelf prospectus, which is a prelim short form prospectus but sets out the aggregate amount of securities expected to be offered under the prospectus over a period of 25 months from the date of the issuer of a receipt for the prelim shelf prospectus
      - (2) must disclose the type of securities that may be distributed
      - (3) must include info that will not vary from the offering of one tranche of securities under the prospectus to another

- (4) certain info ("shelf info") won't be known and can be omitted, such as:
  - i) variable terms of the securities that will be distributed
  - ii) the dollar amount, size and other specific terms of each tranche if not known at the time of filing
  - iii) the variable terms of the plans of distribution if not known at filing
  - iv) name and prospectus certificate of any underwriter if at filing no underwriter is, and it is not known to the issuer that a specific underwriter will be, in a contractual relationship with the issuer required the underwriter to distribute under the base shelf prospectus
  - v) any other info pertaining only to a specific distribution of securities and is not known at time of filing
- c) shelf prospectus supplement NI 44-102 s. 6
  - (1) when tranche of securities is to be distributed under the base shelf prospectus a shelf prospectus supplement must be issued
  - (2) this supplement contains all info omitted from the base shelf prospectus with respect to the particular tranche (all of the "shelf info")
  - (3) incorporates by reference documents that have not been incorporated by reference in the shelf prospectus or in a previous prospectus supplement
- d) prospectus certificates: NI 44-102 s. 6.3(1), item 3 and appendix A
  - (1) because the shelf prospectus is for future offerings, the prospectus certificates will be prospective in nature
  - (2) certificate can take two forms:
    - i) provide statement that as of the date of the last supplement to the prospectus the prospectus and incorporated documents represent full, true plain disclosure....
    - ii) provide statement that the short form prospectus and incorporated documents represent full, true plain disclosure, and further provide in the prospectus supplement that the short form prospectus as supplemented by the prospectus supplement contains all true and plain full disclosure
- 4. market following:
  - a) indication of market following will be either through listing/posting for trading on an approved exchange, or by a rating agency providing an approved rating
  - b) indication of market following intends to assure that info provided in shelf prospectus supplements is quickly reflected in the market for the securities

- 5. variable term debt securities NI 44-102 part 8
  - a) allows for creation of a continuous distribution of debt securities in which the terms of the securities are determined at the time of sale
  - b) when the mature, interest rate and price is determined, the issuer provides a pricing supplement to the shelf prospectus
- 6. at the market distributions NI 44-102 ss. 9.1, 9.2
  - a) defined: non-fixed price distribution of equity securities under the shelf procedures into a pre-existing trading market in which securities of the same class are traded
  - b) allows price of securities to be set at the time of distribution, rather than in the shelf supplement
  - c) these types of offerings are restricted to 10% of the aggregate market value of the issuer's outstanding equity securities of the new class being offered
- 7. distribution of novel derivatives and asset-backed securities NI 44-102 part 4
  - a) concern that shelf-form prospectus will be used to distribute novel forms of derivative or asset backed securities
  - b) novel defined in NI 44-102 s. 1.1
  - c) where an issuer wants to issue a novel derivative or asset backed security, the issuer must file an undertaking before or concurrently with the base shelf prospectus that it will not distribute the securities under the base shelf prospectus without pre-clearing with the applicable regulator the disclosure to be contained in the shelf prospectus supplement
- 8. civil liability:
  - a) for purpose of shelf prospectus, the prospectus includes the shelf prospectus which incorporates disclosure documents, as well as the shelf prospectus supplements which may incorporate other disclosure documents
  - b) liability will ensure where there is a misrep in any of these documents, through any of the means mentioned in chapter 5
- **D. prep procedures NI 44-103**
  - 1. stands for "post-receipt pricing" procedures
  - 2. addresses concern where the price is set before the final prospectus is filed, but there is a waiting period of 2-3 business days, which concerns the underwriter who has committed to purchasing a set number of shares at a set price
  - 3. allows issuer to set the price after the issuer has received a receipt for the final prospectus, which provides more security to the underwriter

- 4. eligibility requirements:
  - a) any issuer that wished to use prep procedures to distribute securities may file a base prep prospectus
  - b) prep procedures may not be used for rights offerings
- **E. multi jurisdictional disclosure system NI 71-101**
  - 1. reasons/purpose for system
    - a) eases distribution being made in Canada and US at the same time, and/or allows US issuers to distribute in Canada where previous distribution have been made in the US in compliance with US regulations
    - b) reduces cost of complying to Canadian and US laws
    - c) assumed that sufficient sophisticated investor review is present where the issuer satisfies a public float test for market following or where the securities have an approved rating
  - 2. permitted offerings using US documentation
    - a) US issuer has a class of securities for which it must comply with continuous disclosure requirements in the US Securities Exchange Act of 1934
    - b) issuer has filed all of its SEC Act filing for a period of 12 calendar months
    - c) issuer is not an investment company or a commodity pool issuer
    - d) issuer has a public float of its equity securities of at least \$75million
    - e) if issuer doesn't meet \$75million float test, it can still distribute the securities in Canada if the securities are:
      - (1) non-convertible debt securities or non-convertible preferred shares that have an investment grade rating
      - (2) convertible debt and preferred shares that are not convertible for at least one year after issuance, and other securities, so long as the securities into which the convertible debt or preferred shares can be converted have a public float of \$75million or more
      - (3) rights, immediately exercisable, to acquire investment grade debt or preferred shares of the issuer
  - 3. mechanics of a MJDS offering
    - a) filing registration statement with SEC and use of prospectus as a selling document based on the information in the registration statement
    - b) distribution proceeds once SEC declares the registration effective, or the registration statement becomes effective otherwise

- c) to conform to Canadian law, issuer must provide a preliminary MJDS prospectus that can take the form of a US prospectus with a supplement containing the additional material required under NI 71-101
- d) issuer selects a principal jurisdiction in Canada to review the material filed under NI 71-101, and files the preliminary prospectus with each jurisdiction in Canada in which it intends to distribute the securities
- e) each jurisdiction will issue a receipt once the preliminary prospectus and supporting documents have been filed
- f) a receipt for the prospectus can be received from the principal jurisdiction once the SEC declares the registration effective in the US
- g) other jurisdictions will then issue a receipt
- h) any jurisdiction can refuse to issue a receipt where there appears to be a problem with the transaction, disclosure, or other special circumstances
- 4. additional Canadian disclosure
  - a) legends must be included with the preliminary prospectus that indicate that the preliminary is not final for the purpose of distribution to the public, that the information is subject to completion or amendment and that the disclosure is prepared in accordance with US law which may differ from Canadian law
  - b) US based financial disclosure must be reconciled with Canadian GAAP either in the notes to the financial statements or in a prospectus supplement
  - c) NI 71-101 require modified issuer/underwriter certificates to the effect that the prospectus contains full, true and plain disclosure of all material facts

## • VII. chapter 10: insider trading

### • A. regulation of insider trading under securities legislation

- 1. what is prohibited:
  - a) there is a prohibition against trading with knowledge of material info
  - b) there is a prohibition against informing other of material info
- 2. when does the prohibition apply:
  - a) trading and informing with respect to knowledge of material information is only prohibited where that information has not been generally disclosed
- 3. who is prohibited from trading or informing?
  - a) persons who have superior access to information due to a special relationship with reporting issuer, including insiders, affiliates & associates
  - b) insider (defined in BCSA s. 1(1)) includes: s. 3(a)
    - (1) directors: or any person acting in a capacity similar to that of the director of a company s. 1(1) BCSA

- (2) senior officer: chairperson or vice chairperson of board, the president, the VP, the secretary, the treasurer or gm of a company or any individual performing similar functions for an issuer. also includes the 5 highest paid employees of the issuer s. 1(1) BCSA
- (3) a person who has control or direction over securities carrying more than 10% of the voting rights of the issuer's outstanding voting securities
- (4) the issuer itself where it has acquired and holds it's own securities
- c) affiliate is defined in s. 1(2)-(4) BCSA to mean the parent or subsidiary of an issuer or any other issuer that is subject to common control s. 3(a)
- d) associate is defined in s. 1(1) BCSA to include: s. 3(a)
  - (1) a person who is a partner of the reporting issuer
  - (2) a trust or estate in which the reporting issuer has a substantial beneficial interest (or for which the reporting issuer is the trustee)
  - (3) an issuer of which the reporting issuer beneficially owns or controls voting securities carrying more than 10% of the voting rights attached to outstanding voting securities of the issuer
- e) a person (and persons who are in a special relationship with such a person) proposing to make, or is a party to, a takeover bid, engage in a reorganization, amalgamation or merger, or to acquire a substantial portion of the property of, the reporting issuer s. 3(a)(ii)&(iii), 3(c)
- f) persons (and persons who are in a special relationship with such a person) engaged in or proposing to engage in business or professional activities on behalf of the reporting issuer s. 3(b)
- g) employees and officers (other than senior officers) of reporting issuer or of a person who is in a special relationship with the reporting issuer s. 3(c)
- h) any person who acquired material info while in a special relationship with the reporting issuer, but who is no longer in the special relationship, is still considered to be in a special relationship with reporting issuer with respect to the specific info s. 3(d)
- i) tippees: a person who would not otherwise be in a special relationship with the reporting issuer, will be deemed in a special relationship with the reporting issuer if: where they receive material information about a reporting issuer from a person whom the tippee knows, or reasonably ought to have known, was/is in a special relationship with the reporting issuer - includes tippees of tippees BCSA s. 3(e)
  - (1) he was informed of a material fact/change of the reporting issuer
  - (2) by a person who was at the time in a special relationship with the reporting issuer

- (3) and knew/ought to have reasonably known that the tipper was in a special relationship with the reporting issuer

- 4. how the prohibition is enforced

- a) penal sanctions

- (1) trading: s. 57.2(2)

- i) person was in a special relationship with the reporting issuer
- ii) person purchased or sold securities of the reporting issuer
- iii) person made the purchase or sale with knowledge of a material fact/change of the reporting
- iv) the material fact/change had not been generally disclosed
- v) defences:

- (a) s. 57.4(1) person reasonably believed the other party to the transaction knew of the material fact/change - standard is reasonable doubt, not balance of probabilities - makes it easier to accused
- (b) s. 57.4(3) entered into transaction under an automatic dividend reinvestment plan, or because of a written legal obligation (ex. sell at set price) that the person entered into before knowing the material info
- (c) s. 57.4(4) where a person was acting as agent/trustee on the basis of instructions from the principal where the principal did not know of the material fact/change
- (d) s. 57.4(5) a person other than an individual enters into a contract directed by a person who does not know of material info and is not acting on the encouragement of a person that has knowledge

- (2) informing: s. 57.2(3)

- i) the accused was in a special relationship with the reporting issuer
- ii) the accused informed another person of a material fact/change with respect to the reporting issuer
- iii) the material fact/change had not been generally disclosed
- iv) defences:

- (a) s. 57.4(2) person reasonably believes the other person knows of the material fact or change

- (3) informing with respect to takeover bid, etc s. 57.2(4)

- i) person proposing to make a takeover bid for the securities of a reporting issuer, or to become a party to a reorganization,

amalgamation, merger, arrangement or similar business combination with a reporting issuer

- ii) informs another person of a material fact/change with respect to reporting issuer
- iii) the material fact/change has not been generally disclosed
- iv) the informing was not necessary to effect the takeover bid or business combination
- v) defences:
  - (a) s. 56.4(2) person reasonably believes the other person knows of the material fact or change
- (4) penalties
  - i) s. 155(1)(b) creates offense
  - ii) s. 155(5) for insider trading: no less than the profit made by the person, and no more than the the greater of \$3million or triple the profit made
  - iii) s. 155(6) for informing: no less than the profit made by the person, and no more than the greater of \$1million or triple the profit made
- b) civil actions
  - (1) by person who traded with person in special relationship s. 136(2)
    - i) D was in a special relationship with the reporting issuer
    - ii) D purchased or sold securities of the reporting issuer from/to the P
    - iii) D made the purchase/sale with knowledge of a material fact/change about the reporting issuer
    - iv) the material change/fact had not been generally disclosed
    - v) defences: 136(2)(c)&(d)
      - (a) reasonable belief the material info had been disclosed
      - (b) P know or reasonably ought to have known of the material info
    - vi) D is liable to compensate the seller/purchaser for damages as a result of the purchase/sale
  - (2) by person who traded with a tippee: recourse against tipper s. 136(3)
    - i) D is the reporting issuer, in special relationship with reporting issuer, or proposes to do a business combination with reporting issuer
    - ii) D informed another of material fact/change of reporting issuer
    - iii) the material fact/change had not been generally disclosed
    - iv) defences: s. 136(3)(d)-(f)

- (a) tipper thought the information had been generally disclosed
- (b) P knew, ought to have reasonably known, of material info
- (c) as against reporting issuer/person in special relationship, the info was given in the course of business
- (d) as against person proposing biz combination, giving the info was necessary to effect the takeover bid/biz recombination
- v) D is liable to compensate for damages any person that sells the securities or purchases securities for the reporting issuer from any person that the D informed
- (3) actions by or on behalf of the reporting issuer s. 136(5)
  - i) person was an insider, affiliate or associate of the issuer
  - ii) person either bought or sold securities with knowledge of material information, or informed another of the material information
  - iii) the material information had not been generally disclosed
  - iv) defense
    - (a) reasonable belief that the information had been generally disclosed
    - (b) with respect to informing, giving info was necessary in the course of business of the issuer
  - v) D will be liable to account to the issuer for any benefit or advantage received
  - vi) where reporting issuer does not take this action itself, the securities commission or a security holder can bring derivative action s. 137(1)
- c) administrative sanctions
  - (1) cease trade orders: s. 161(1)(b)
  - (2) removal of exemptions: s. 161(1)(c)
  - (3) prohibition from acting as director or officer: s. 161(1)(d)
  - (4) administrative penalty: s. 162
- **B. regulation of insider trading under criminal code**
  - 1. what is prohibited: s. 382.1
    - a) there is a prohibition against trading with knowledge of material info
    - b) there is a prohibition against informing other of material info
  - 2. when does the prohibition apply: s. 382.1(1)
    - a) trading and informing with respect to knowledge of material information is only prohibited where that information has not been generally disclosed
  - 3. prohibitions on trading

- a) s. 382.1(1) a person is guilty of an indictable offense and liable to imprisonment for a term not exceeding ten years who, directly or indirectly, buys or sells a security, knowingly using inside info that they *this maps onto "special relationship" for the most part, CC does not cover tippees of tippees, and it covers all shareholders rather than those with 10% voting rights*
- (1) possess by virtue of being a shareholder of the issuer
- (2) possess by virtue of, or obtained in the course of, their business or professional relationship with the issuer
- (3) possess by virtue of, or obtained in the course of, a proposed takeover or reorganization of, or amalgamation, merger or similar business combination with, the issuer
- (4) possess by virtue of, or obtained in the course of, their employment, office, duties or occupation with the issuer or with a person noted above
- (5) obtained from a person who possess or obtained the information in a manner referred to above
- b) re *knowingly using inside information*
- (1) s. 382.1(4) defines inside information as: information relating to or affecting the issuer of a security that:
  - i) has generally not been disclosed and could reasonably be expected to significantly affect the market price or value of the securities
  - (2) this maps onto BCSA definition of "material fact" and requirement that the information not be generally disclosed
  - (3) "knowingly using" may be a problem because this becomes an effective defense for the accused - see text 378
- 4. prohibitions on informing
  - a) s. 382.1(2) a person who possesses, or has obtained, insider information in any of the manners described in s. 382.1(1) commits an offence, and is liable to imprisonment of up to 10 years or a fine in lieu of imprisonment, if the person:
    - (1) knowingly convey inside information to another person
    - (2) know either,
      - i) there is a risk that the other person will use the information to buy or sell a security to which the information relates
      - ii) that the other person may convey the information to another person who may buy or sell a security to which the information relates
  - b) there is an exception where the information is conveyed in the necessary course of business

- c) this covers takeover bid or business combination by virtue of s. 382.1(1)(c)
- d) this does not cover tippees of tippees, because it is based on above sections which also did not cover tippees of tippees

## • **VIII. chapter 13: takeover bid regulation**

### • **A. what it is**

- 1. takeover bid is a method of obtaining control over a corporation
- 2. a takeover refers to a change in the control over management of the issuer or firm
- 3. a takeover bid is a general offer to shareholders to purchase shares of the particular issuer, the result of which will be that the offeror will obtain sufficient shares to control the target

### • **B. rules for takeover bids (responses to takeover bid concerns-see policy)**

- 1. provide information/disclosure requirements
  - a) takeover bid circular: NI 62-104 s. 2.10 & 62-104F1
    - (1) provide name of offeree issuer, securities subject to the bid, time periods, consideration, ownership of securities of the offeree issuer, trading in the securities of the offeree issuer, withdrawal rights, source of funds, arrangements with directors and officers of the issuer, etc
  - b) directors' circular: NI 62-104 s. 2.17 & 62-104F3
    - (1) must recommend to accept or reject, or indicate why a recommendation is not being made
    - (2) information re responses such as a merger or acquisition, sale of a material amount of assets of the issuer, issuer bid or other acquisition of shares, or material change in capitalization
    - (3) information on ownership of and trading in securities of the offeree, whether they have accepted or intend to accept the offer, arrangements or agreements between the offeror and offeree issuer and the directors or officers of the offeree issuer to make payment to directors or officers due to loss of office upon a takeover, interests of directors or officers of the offeree issuer in any material contract to which the offeror is a party
- 2. provide time to assess the information - min bid period NI 62-104 s. 2.28
- 3. first come, first serve offered not allowed NI 62-104 s. 2.26(1)
  - a) where bid is for less than all of the shares, the shares from each shareholder will be taken up proportionately to the total number of shares bid on vs total number of shares tendered
- 4. lock-up prevented - withdrawal rights NI 62-104 s. 2.30

- a) protects those who tender shares earlier - shareholder has 35 days from tendering shares to withdraw their tender
- 5. unequal consideration not allowed NI 62-104 s. 2.8
  - a) bid to all securities holders in the province s. 2.23(1)
  - b) identical consideration to all members of the class of equity securities sought s. 2.23(3)
  - c) no collateral agreements with target shareholders that give one or some of them greater consideration than other shareholders would get s. 2.24
- 6. looting not allowed - formal valuation requirements
  - a) corporate law constraints: provisions for oppression remedies and fiduciary duties, appraisal rights with respect to post-takeover amalgamations
  - b) formal valuations: offeror must provide a formal valuation in certain circumstances, such as "going private" or where the offeror is an insider, affiliate or associate of the target issuer
  - c) multilateral instrument 61-501: protects minority shareholders where bidder gets sufficient shares to have control of an issuer and uses control to affect minority shareholder rights
- 7. other concerns dealt with
  - a) adequate financing to pay for tendered shares NI 62-104 s. 2.27
  - b) delinquent take-up and payment - take up within 10 days of expiry of bid and pay within 3 days of take up NI 62-104 s. 2.32
  - c) limits on acquisitions during the bid period - announce intention to make bid period acquisitions, wait 3 days from bid commencement, max. 5% of outstanding target shares during bid period, normal market purchase, end of day press release NI 62-104 s. 2.2
  - d) restrictions on sales during bid period NI 62-104 s. 2.7
- C. **when do these rules apply?**
  - 1. whenever a takeover bid has occurred NI 62-104 s. 1.1 defines takeover bid
    - a) takeover bid is defined to mean an "offer to acquire" (except an offer or solicitation of an offer) voting or equity securities held by a person in the province where the result of the acquisition will be that the offeror will end up owning (directly or beneficially or having control) 20% or more of the outstanding shares of a class of voting or equity securities
  - 2. exceptions to the application of takeover bid rules
    - a) normal course purchases: NI 62-104 s. 4.1 - purchases of not more than 5% of the securities of a class provided that: the purchase price does not exceed the market price, and only 5% are purchased in any one year period

- b) control block purchases: NI 62-104 s. 4.2 - where the offer is made to 5 or fewer persons, it is not made generally to security holders of the class of equity securities sought, and the offer price does not exceed the market price of the securities by more than 15%
- c) closely held company exemption: NI 62-104 s. 4.3 - where the number of security holders of the class sought is less than 50, the bid is not for shares of a reporting issuer, there is no published market of the securities that are the subject of the bid
- d) foreign takeover bid: NI 62-104 s. 4.4
- e) limited relevance to jurisdiction: NI 62-104 s. 4.5 - where very few shareholders representing a small percentage of the outstanding shares of the class sought and who are resident in the province, there is no need to comply with this jurisdiction's regulations so long as similar regulations of another jurisdiction are being complied with
- f) exemption applications: NI 62-104 s. 6.1 - at commission's discretion where exemption would not be prejudicial to the public interest
- **D. anti avoidance provisions**
  - 1. acting jointly or in concert NI 62-104 s. 1.1, s. 1.9: offeror's securities includes securities of anyone acting jointly or in concert with the offeror,
  - 2. rights to acquire securities in the future NI 62-104 s. 1.8: deemed ownership of securities that can be acquired by exercise of conversion right or some other right to acquire the securities
  - 3. direct or indirect offers NI 62-104 s. 1.10: ex offers to acquire shares of a holding company that owns securities of the issuer
  - 4. linked bids NI 62-104 s. 2.4: offer consideration equivalent to highest offered in the previous 90 days
    - a) no acquisitions for 20 days after expiry of bid except by transaction generally available to all shareholders of the class subject to the bid s. 2.5
  - 5. early warning disclosure NI 62-104 s. 5.2: where a person acquires control of over 10% of the securities of a class of voting or equity securities they must file a press release, and also whenever the same person acquires a subsequent 2% increase they must file a press release and file report with the commission
- **E. takeover bid defenses responses**
  - 1. typical defenses of takeover target to prevent the takeover
    - a) new issue of shares into friendly hands to defeat the controlling interest of the bidder
    - b) find a "white knight" - an acquirer who is more acceptable to the target often because the white knight will not replace management

- c) issuer bid - issuer will bid for its own shares and compete with hostile bid
- d) "crown jewel" - discourage bidder by selling off the asset/assets which the bidder is primarily after
- e) "crown jewel option" - grant an option to a 3rd party to buy the crown jewel at an exceptionally low price in the event the hostile bidder's bid succeeds
- f) bust up fee - arrangement with white knight, where if the white knight's bid does not succeed the target must pay a significant sum of money to the white knight, meaning the hostile bidder will acquire the target with a substantial debt
- g) show stopper - attempt to delay or defeat the bid by commencing litigation or seeking an injunction until the litigation is resolved
- h) poison pills
  - (1) poison preferred shares: issued to current stockholders as a stock dividend, which are convertible into common shares of the target and allow the holder to redeem the shares if the bidder acquires some specified percentage of the voting rights
  - (2) poison rights: rights distributed as a dividend, where the bidder acquires more than a specified percentage of the target's voting rights, these rights flip over into a right to buy the shares of the amalgamated corporation at a price that is very low
- 2. court challenges to the validity of takeover bid defences
  - a) basis of action and standing to sue: a shareholder may challenge the validity of a takeover bid defense as a person action, a derivative action or an oppression application
  - b) proper purpose test:
    - (1) *Howard Smith*: was the substantial purpose for which the power was used inconsistent with the nature of the purposes for which the power was intended
  - c) best interests test:
    - (1) *Teck Corporation*: changes proper purpose test to a test that a purpose will be improper where the director does not act in the best interests of the corporation- correct test is: the director must act in good faith, have reasonable grounds for their belief that the takeover will be negative
  - d) proportionality test: reasonable in relation to the threat posed and shareholder approval:
    - (1) *Producers Pipelines*: directors must exercise powers in bona fide best interests of corporation, whenever possible shareholders should get a

say, defense cannot go so far as to deprive shareholders of ability to respond to a takeover bid or competing bid

- (2) *CW Shareholding: Producers Pipelines* goes to far to extent the onus is put on directors - directors of target should be protected by business judgement rule
- (3) *Pente Investment Mgmt (Maple Leaf)*: adopts US *Paramount* - provided the decision taken is within a range of reasonableness, the court ought not substitute its opinion for that of the board even though subsequent events may have cast doubt on the board's determination
- 3. NP 62-202:
  - a) influenced by *Producers Pipeline*
  - b) shareholders of the target company should be free to make fully informed decisions in the context of takeover bids - defensive measures may interfere with this right
  - c) prior shareholder approval of a company's defensive actions would alleviate any concerns that the defensive measure was abusive to shareholder rights
- 4. response of securities commission to poison pills
  - a) where a poison plan has outlived its usefulness in terms of promoting an auction for hte shares of the issuer, the commission can impose a cease trade order that would prevent (in most cases) the shareholder from exercising the rights
  - b) the questions to be addressed (the "regal test")
    - (1) *Re Canadian Jorex*: only question to decide was whether the rights plan had served its purpose in facilitating an action for Jorex
    - (2) *Lac Minerals and Regal Greetings*: four questions for determining if poison pill has outlived it's usefulness
      - i) can the outstanding bid proceed if the rights plan is not removed
        - (a) has mgmt made it clear that the bid will proceed if the minimum conditions for the bid have been met
      - ii) will keeping the plan in place lead to any further enhancement of the existing bid or bids
      - iii) would continuance of the plan lead to further bids
        - (a) the longer the period of time, the less likely for future bids
      - iv) has the plan been approved by the targets shareholders
  - c) the significance of shareholder approval

- (1) *Re Samson*: shareholder approval is powerful, but not necessarily conclusive, evidence of how the shareholders want their collective interests to be protected in a takeover bid situation - commission must consider particular circumstances in each case
- d) significance of not having shareholder approval
  - (1) *Re CW Shareholdings*: cease order issued because plan put in place without shareholder approval and in the face of a bid for shares - but a plan would be allowed to continue where it was to protect shareholders from a coercive bid
  - (2) *Re Samson*: coerciveness is a powerful but not necessarily conclusive factor to be considered in applying the "regal test"
  - (3) *Re Ivanhoe III*: right plan permitted to continue without shareholder approval - 2 steps:
    - i) assess whether the plan should be permitted to stand even though there was no shareholder approval (ex in face of coercive bid)
    - ii) if allowed to stand, has the time come for the plan to be terminated (ex has it served its usefulness to stop coercive bid and in permitting target management to seek alternate bids)
- e) factors approach
  - (1) *Re BGC Acquisition*: balance must be struck between letting shareholders decide for themselves and letting mgmt/the board fulfil their fiduciary duties to seek a higher price for the shares from alternative bidders
  - (2) *Re Royal Host*: no one specific test, takeover bids are fact specific - commissions indicate factors that might be relevant - page 471
- F. issuer bid regulation - see text page 472