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Canadian Dual-Listed Company Insiders May Become Subject to U.S. Short-Swing Profit and Insider Reporting Rules

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Buried in the *National Defense Authorization Act for Fiscal Year 2024*, which the U.S. Senate passed earlier this year, is a provision that, if enacted, will eliminate exemptions relied upon by insiders of dual-listed Canadian public companies and other foreign private issuers from obligations imposed under section 16 of the *Securities Exchange Act of 1934* (section 16).

As a consequence of the proposed legislation, officers, directors and shareholders holding 10% or more of dual-listed Canadian issuers, including filers under the multijurisdictional disclosure system (MJDS) and other foreign private issuers, will become subject to the following U.S. rules:

- Insider reporting: timely public filing of insider reports outlining trading in the issuer's securities
- Disgorgement of "short-swing" profits: strict liability to the issuer for profits made on purchases and sales, or sales and purchases, of the issuer's securities within a six-month period, regardless of possession or misuse of any insider information
- No short sales: prohibition on selling securities of the issuer that they do not own

Using these three rules, section 16 is designed to prevent insiders from exploiting information they obtain by virtue of their close relationship with the issuer, and profiting at the expense of the general investing public.

Senators John Kennedy (R-La.) and Chris Van Hollen (D-Md.) have been driving the proposed legislation, acting on reports that the exemption has allowed insiders of Russian and Chinese companies to avoid significant losses by selling shares in advance of declines in share price. Their premise is straightforward: level the playing field by subjecting foreign private issuers to the same rules as U.S. domestic issuers. However, Canada, which has its own rigorous insider reporting and insider trading regimes, is being caught up in this broad-brush approach, and the principles underlying the long-standing MJDS accord between Canada and the United States are being undermined in the process.

Canadian corporate and provincial securities legislation addresses the same concerns as those addressed by section 16. Insiders of Canadian issuers are required to report their trades publicly on the System for Electronic Disclosure by Insiders and are subject to strict prohibitions, coupled with potential criminal sanctions, on purchasing or selling shares while in possession of undisclosed material facts or material changes. Canada's federal corporate statute prohibits insiders from engaging in short sales.

The proposed U.S. legislation is the third attempt by lawmakers to eliminate the exemption, with this attempt subsumed into a 2,000+ page defence bill. The bill is in or headed to conference between the House and Senate to resolve differences and may then be signed into law by President Biden. Once enacted, the Securities and Exchange Commission (SEC) will have 90 days to issue new rules or amend existing rules before the legislation takes effect.

Unless the proposed provision eliminating the section 16 exemption is removed entirely from the final version of the bill signed by President Biden, or is revised to allow the SEC to grant exemptions to Canadian or other classes of issuers (and even then, there is no indication that the SEC would entertain such exemptions), insiders of dual-listed Canadian issuers will become subject to the section 16 requirements.

We expect that the impact on dual-listed Canadian issuers and their insiders will be a significant administrative burden and increased costs of complying with two similar but different systems with different timing requirements, definitions of insider, specific form requirements and filing mechanisms, and the risk of exposure to litigation from an active plaintiff's bar in the United States for profit disgorgement for short-swing trading.

Timing of the passage of the legislation is unclear, but some informed observers have suggested that it could be approved before the end of 2023.

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