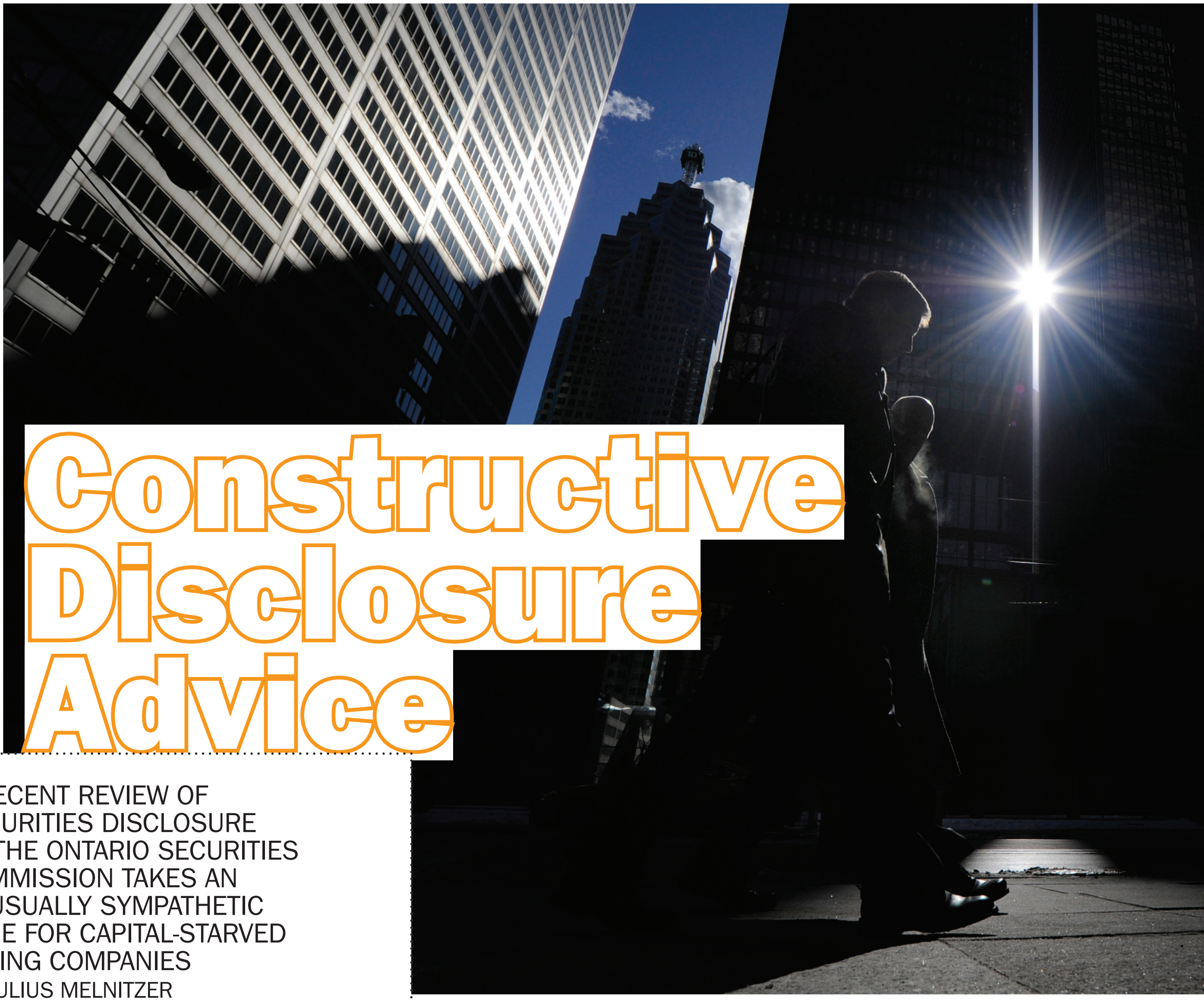

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Constructive Disclosure Advice

A RECENT REVIEW OF SECURITIES DISCLOSURE BY THE ONTARIO SECURITIES COMMISSION TAKES AN UNUSUALLY SYMPATHETIC TONE FOR CAPITAL-STARVED MINING COMPANIES

BY JULIUS MELNITZER

IT'S NOT OFTEN that a regulator, especially a securities regulator, follows poor marks with gentle encouragement. That's particularly so in the case of junior mining disclosure. But the Ontario Securities Commission seems intent on breaking the mould.

In many cases, regulators come down hard on junior miners. The BC Securities Commission, for example, has been severe with several companies, including the egregious case of Barkerville Gold Mines Ltd., which claimed access to as much as 90 million ounces of gold. The OSC itself minced no words in 2013, when a review of 50 technical reports led it to find an "unacceptable level of compliance."

If the truth be told, the results were hardly better following the OSC's review earlier this year of the annual and interim Management's Discussion & Analysis (MD&A) filed by 100 Ontario junior miners. And junior they were: none had a market value of over $100 million, with the majority under $25 million and only four of the companies having raised capital by way of prospectus in the preceding fiscal year.

Following the review, a Staff Notice issued in February concluded that no less than 70 per cent of companies that had no revenue provided limited disclosure about their plans or progress of their projects, 39 per cent didn't break down their expenses, and 37 per cent didn't break down their exploration and evaluation assets. Other disclosure issues included liquidity, capital, related party dealings, risk assessment and the use of proceeds from financing. Miners with a working capital deficiency provided just general or no discussion about where they planned to get more cash and how they proposed to continue operations. In short, the overall problem was that issuers took a "boilerplate" approach to MD&A.

"Drafting a proper MD&A is not instinctive and it's certainly not just a matter of filling out forms or layering on what was said the previous quarter — which is how even some experienced management teams look at it," said Paul Goldman in Goodmans LLP's Vancouver office. "You have to approach it as a blank sheet of paper every single

time and really think about it in order to be responsive."

For the most part, the fairly dismal results should not have been news. Indeed, in recent years, it has become quite clear that disclosure by mining issuers is worrying regulators: witness the BCSC's 2012 Mining Report and the OSC's technical report guidance release in July 2013.

"If you look at disclosure in this market in the last couple of years, there are many instances, particularly with regard to liquidity and capital resources, where companies are still not being clear," Goldman said. "Instead, what we've seen is the old boilerplate about needing more capital to do what we want to do, and although we're thumping the tub to get it, we might have to do bad things if we don't."

In stark contrast to its harshly worded denunciation

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of the level of compliance in 2013, however, the OSC now seems to be on a different tack. The barely veiled threat of increased enforcement found in previous reports is a long way from the tone of this most recent review. Instead, the OSC called its report an “educational tool” intended to assist miners with proper disclosure in the future. No threats, veiled or otherwise, of sanctions for conduct past.

“Some people are hemming and hawing that the Staff Notice will add quite a burden to the existing workload for junior miners, but the OSC’s mandate is to protect both the capital markets and the investors,” said Ivan Grbesic in Stikeman Elliott LLP’s Toronto office.

The OSC balancing act, it turns out, is nothing new.

“In a market where junior miners are an important segment, regulators are perennially trying to find a balance between not inhibiting capital formation and getting more extensive disclosure in this arena, where greater risk to investors might exist,” said Alexander Moore in Davies Ward Phillips & Vineberg LLP’s Toronto office.

Lately, regulators have been under some pressure to assist small miners, most of whom are facing a daunting economic environment. The BCSC, for example, has proposed rule changes that would make it less difficult for TSX Venture companies to raise money from existing investors. While the OSC hasn’t gone that route, the velvet glove approach in the latest report, combined with a substantial fee reduction this year, suggests that it is well aware of the challenges facing junior issuers.

“My overall take is that the Commission is recognizing the important role that junior issuers play in Canadian capital markets and that it is trying to help them with disclosure in market conditions that have strained their resources,” said Adam Taylor in McCarthy Tétrault LLP’s Toronto office.

Not the least among the challenges faced by these small companies is their relatively unsophisticated nature marked by a lack of internal resources to deal with

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disclosure burdens properly.

"Many juniors don't have a full-time CFO although they might have a part-time CFO who works for a few companies," said Tom Fenton of Toronto's Aird & Berlis LLP. "Many of them have limited budgets, many are thrashing around because they're unable to raise capital and some will even be de-listed."

The OSC's approach is all the more welcome in light of the Commission's rejection of a recent initiative allowing junior companies to do annual instead of quarterly MD&As.

"That initiative is no longer under consideration, but it was an acknowledgement of the huge burden that orderly filing on a quarterly basis imposes on management," Fenton said. "It may well be that this latest Staff Notice is a follow-on from the recognition that something had to be done."

Fenton lauds the Staff Notice as "good, helpful guidance." Most mining lawyers have a similar view.

"The OSC is to be commended for its constructive approach and for the way the Staff Notice provides specific examples of the mistakes being made and how they can be corrected," said Goldman. "Unlike all the marketing fluff, a well-written MD&A can be very instructive and is one of the key things for me when I'm looking at documents."

The consensus, then, seems to be that the Staff Notice is both aimed at the right target market and has the appropriate degree of specificity.

"This is a good effort by the Commission to reach out to people who actually prepare the first MD&A drafts," Taylor said. "They've taken things they've done in other contexts and put it in the mining context."

Mining lawyers are urging their clients to respond positively.

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"I'm telling clients to be proactive and produce an MD&A that uses the guidelines to indicate what the company has done, where it stands, where management expects to go and how it expects the company to get there," Grbesic said.

Goldman believes that MD&A should allow investors to "get into the heads" of management.

"My advice is to be graphic and clear about who you are, what kind of money you have in your jeans, what you're doing and where you're going," he said. "People aren't stupid and anyone experienced in reading these documents can spot evasiveness a mile away."

Notwithstanding the OSC's gentle approach to deficiencies, lawyers are clear that issuers who ignore the guidance do so at their peril.

"The guidance provides an opportunity to improve disclosure, without running into a company-specific continuous disclosure review, which is not great for a client's reputation," Moore said. "Also, responding to these industry-wide guidelines is less expensive than dealing with a targeted letter with fixed timelines."

Going forward, a continuous disclosure review that concludes disclosure is insufficient could force a restatement of financial results as well as the MD&A.

"That's more likely to happen now that we have the guidance, which amounts to a best-practices handbook," Fenton said. "And if it does happen, we're talking a lot of extra time and cost."

Proactivity is especially important for miners who are contemplating a round of financing, and thinking of incorporating their MD&A in a prospectus.

"We all know what the current market looks like," Grbesic said. "Only small windows are opening up and the last thing you want when they do is to have management distracted by a continuous disclosure review."

Indeed, Fenton's partner Martin Kovnats says the constructive approach by the OSC should not mask the impact that the poor results of the review that led to the guidance will have on potential investors generally.

"I'm telling clients who are thinking of investing in juniors to be cautious because the OSC survey showed a lot of deficiencies," he said. "For example, PIPE [private investment in public equity] investors may now be looking for more extensive warranties and representations."

To be sure, taking heed of the guidance is not necessarily a panacea.

"Complying with the best practices doesn't give anyone a 'get out of jail free' card, but it does allow companies to manage expectations," said Kovnats. "Getting it right doesn't mean that regulators or investors won't ask for more, but at least if you're within the zone, you're not likely to get into a lot of trouble."

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