INTRODUCTION

As credit markets continued to be tight and capital markets remained volatile in 2009 and early 2010, many issuers, particularly in the mining industry, raised capital through PIPE transactions. The term PIPE transaction is short for Private Investment in Public Equity. In a PIPE transaction, investors typically acquire equity or equity-linked securities, such as convertible debentures or preferred shares, at a discount to the market price directly from a publicly traded company on a private placement basis. The investor is able to freely resell the securities either at the end of the statutory hold period (generally four months in Canada) or through a prospectus if it negotiates for registration rights.

PIPE transactions can be placed through an agent or an underwriter to a broad group of investors or placed directly by an issuer to a single investor or a small group of investors. This paper is based on a review of 11 PIPE transactions placed in 2009 and 2010 directly by Canadian issuers listed on the Toronto Stock Exchange (the "TSX") to a single investor (or a small group of investors). The 11 transactions ranged in size from approximately $75 million to $1.5 billion.¹

Interestingly, whereas PIPE transactions in the United States are often completed by way of preferred shares, in Canada, it is far more common for issuers to issue straight equity. In fact, of the 11 transactions referred to below, none involved the issuance of preferred shares and ten included the issuance of equity alone or equity together with debt.

BENEFITS OF PIPE TRANSACTIONS

For some issuers, a PIPE transaction may be the only economical option available to raise capital. For other issuers, a PIPE transaction may be an attractive alternative to public offerings as they offer increased speed and potentially lower costs as typically no disclosure

¹ Davies recently acted for Temasek Holdings (Private) Limited in its $500 million PIPE investment in Inmet Mining Corporation that closed on April 23, 2010, and its US$100M PIPE investment in Platmin Limited that was announced on March 29, 2010. The investment into Inmet was made through subscription receipts that are exchangeable into Inmet common shares for no additional consideration upon the satisfaction of certain conditions. The investment into Platmin was made through a US$100 million convertible debenture.
document is prepared and there is no (or little) involvement of any Canadian securities commission. In addition, through a PIPE transaction, an issuer may be able to develop a long term and/or strategic relationship with a large shareholder. Finally, depending on its bargaining power, the issuer may be able to negotiate certain protections such as hold periods and/or standstills.

PIPE transactions can present an attractive opportunity for investors as they are usually offered at a discount to the market price and typically include some additional rights or protections, such as board seats, pre-emptive rights, registration rights, anti-dilution protection or veto rights.

**REGULATORY CONSIDERATIONS**

**Securities Laws**

PIPE transactions are private placements and are therefore subject to Canadian securities laws. The issuance of securities in a PIPE transaction will be made under one of the exemptions from the prospectus requirements and generally there is no (or little) need for involvement of any Canadian securities commission. The issued securities will generally be subject to a four month statutory hold period unless the investor is a control person, in which case further restrictions on resale will apply.

Under Canadian securities laws, if an investor acquires 10% or more of the voting or equity securities of any class (or securities convertible into 10% or more of such securities) of a public issuer, the investor must "promptly" issue a press release and within two business days file an early warning report with the Canadian securities authorities. The early warning report and press release must contain certain prescribed information including the number and percentage of securities owned by the investor after giving effect to the transaction as well as its purpose in effecting the transaction. An investor will be required to file another press release and early warning report each time that it acquires an additional 2% of that class of securities or if there is a change in any material fact in the initial (or any amended) early warning report.

In addition to its early warning obligations, an investor that acquires 10% or more of an issuer's voting securities must file an insider report that discloses its ownership within 10 days of the transaction. Again, this includes securities or other rights convertible into voting securities. Under recently adopted changes to insider reporting rules, the investor will thereafter be required to file an insider report within 5 days after it purchases or sells any further securities of the issuer.

**TSX Approval**

The issuance of securities listed on the TSX or securities convertible, exchangeable or exercisable into, or for, such listed securities will require the approval of the TSX. In

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2 These new insider reporting rules have a transitional period such that for transactions occurring on or before October 31, 2010, insiders may file insider reports within 10 days rather than 5 days.

3 For purposes of this paper, I have assumed that all issuers are TSX listed companies. Of course, TSX rules would not apply to an issuer that is not so listed and the rules of other stock exchanges would apply if the issuer was listed thereon.
considering whether to approve such a transaction, the TSX will review the relevant definitive documents and, based on recent experience, will likely be most interested in the following:

- any discount to the market price that does not fall within permitted ranges,
- whether dilution will exceed 25%,
- the creation of any new 20% shareholder or other factors that would give the investor the ability to materially affect control of the issuer, and
- the involvement of insiders.

The TSX will likely require shareholder approval if the transaction:

- was priced below the permitted discount,
- was priced at a permitted discount, but resulted in dilution of 25% or more to existing shareholders,
- resulted in a new (or potentially new) 20% shareholder, or
- involved an issuance to insiders beyond permitted thresholds.

In addition, the TSX has broad discretion to require shareholder approval if it believes that the transaction would have an adverse effect on the quality of the marketplace.

**Competition Act and Investment Canada Act**

PIPE transactions involving acquisitions of no more than 20% of an issuer's voting shares will not be subject to pre-merger notification under the *Competition Act*. Similarly, PIPE transactions involving acquisitions by non-Canadians of less than one-third of an issuer's voting shares will not be subject to pre-closing review under the *Investment Canada Act*, unless the Governor in Council orders a review on the basis of national security concerns. PIPE transactions involving acquisitions of voting shares in excess of these thresholds may be subject to pre-merger notification under the *Competition Act* or pre-closing review under the *Investment Canada Act*, provided that certain prescribed financial thresholds are also exceeded. In all PIPE transactions, even those involving acquisitions below the thresholds stated above, issuers and investors should consult with anti-trust lawyers to confirm whether the transaction would be subject to either the *Competition Act* or the *Investment Canada Act*.

Issuers and investors will also need to consider anti-trust legislation in any other jurisdictions in which the issuer maintains a secondary listing or does business.

**Commonly Negotiated Rights and Obligations**

The rights and obligations of investors and issuers will vary from transaction to transaction based on the needs of the parties, the balance of the negotiating power and the particular facts of the transaction. Set out below are some of the more commonly negotiated rights and obligations.
Rights for the Benefit of the Investor

Board Seats

In nine of the 11 reviewed transactions the investor was granted a right to nominate at least one individual to the board of directors. This right fell away if the investor owned less than a minimum percentage of the issuer, which generally ranged from 5% to 15% of the issuer.

Some investors also negotiated for their board nominee to either be on committees of the board or to be considered for inclusion on such committees.

Pre-emptive Rights

In nine of the 11 reviewed transactions, the investor was granted a pre-emptive or participation right that, subject to varying limitations and conditions, enabled the investor to maintain its level of equity ownership by either participating in future offerings of securities by the issuer or acquiring securities directly from the issuer following the closing of such future offerings.

In recent transactions, we have been advised by the TSX that it will permit pre-emptive rights to be issued as part of a transaction, however it has cautioned that if the investor is an insider at the time of a future pre-emptive issuance, the TSX would consider such issuance in light of its rules relating to issuances to insiders.

Issuers and investors have addressed this point in varying ways. Some issuers have tried to negotiate that they would not have to comply with pre-emptive provisions if doing so would require them to seek shareholder approval. In other transactions, issuers have agreed to seek shareholder approval if required, provided that the shareholder approval process would not delay the contemplated offering and if shareholders vote against the pre-emptive issuance then the investor loses the pre-emptive right for such offering. Finally, some investors have required issuers to delay offerings until shareholder approval is obtained and if not obtained, then the issuer is not permitted to complete the proposed offering.

Registration Rights

It is far more common for U.S. issuers to grant registration rights than Canadian issuers as statutory hold periods are longer in the United States and more stringent resale restrictions apply in the United States to investors that are "affiliates" (generally 10% holders) whereas in Canada, more stringent resale restrictions apply to "control persons" (generally 20% holders). Notwithstanding that after a four month statutory hold period, investors who are not control persons may legally be permitted to freely sell their securities, some investors have realized that given the size of their investment relative to the liquidity of the security, it could take months to dispose of the securities through the open market. As such many investors, even those that will not become control persons, often negotiate for registration rights. In four of the 11 reviewed transactions, the investor was granted registration rights.

The threshold at which the prospectus registration right fell away, the number of prospectus registration rights, postponement rights for the issuer in certain circumstances, and who bore the costs of the prospectus registration rights were some of the points of negotiation that varied among the deals.
Anti-Dilution Protection

Anti-dilution protection is far more common in equity linked securities than it is in straight equity securities. All of the equity linked transactions included fairly standard anti-dilution protection for stock splits, consolidations and issuances of distributions to all shareholders. Far less common, though sometimes negotiated for, is anti-dilution protection that lowers the conversion or exercise price of a convertible security in the event that the issuer completes a future offering of securities at a price lower than the market price at the time of the future offering or the then applicable conversion or exercise price. In one transaction involving equity securities, the issuer agreed to a cash payment to the investor if, subject to certain restrictions and exclusions, the issuer issued equity securities at a price less than what the investor paid.

When negotiating and drafting anti-dilution provisions, issuers and investors need to be mindful of the rules relating to anti-dilution provisions set out by the TSX in its December 7, 2009 Staff Notice. For example, the notice provides that, absent shareholder approval, the TSX will not accept downward adjustments to the exercise or conversion price of a convertible security when a listed issuer completes a subsequent offering of securities at a price that is lower than the conversion price if such price would not have been permitted at the time that the convertible security was issued. In addition, the notice provides that holders of convertible securities may not participate in "regular" distributions to common shareholders without the prior consent of the TSX. Finally, the notice also provides that where, as is fairly common, a convertible security has a basket clause that gives the issuer's board of directors the authority to amend the exercise or conversion price at its discretion in the event of a dilutive issuance not specifically contemplated by the governing document, any amendment to the exercise or conversion price effected under such clause will be subject to the prior consent of the TSX.

Veto Rights

None of the 11 reviewed transactions provided the investor with direct veto rights relating to significant actions or important decisions regarding the issuer and its business. In the transactions involving the issuance of debt, the issuers did agree to some restrictive covenants that limited their ability to take certain actions without obtaining the consent of the investor. In addition, in one transaction, an investor entered into a shareholders' agreement with the issuer relating to one of the issuer's subsidiaries that resulted in the investor being granted some veto rights as it related to the business of the subsidiary.

When negotiating veto rights, investors and issuers need to be mindful that, depending on the scope of the veto rights, the TSX could consider an investor's ability to block significant transactions as tantamount to having a "material affect on control" of the issuer with the result that shareholder approval could be required even where the investor will not become a new 20% shareholder of the issuer.

Rights for the Benefit of the Issuer

Transfer Restrictions/Hold Periods

In eight of the 11 reviewed transactions, issuers were able to negotiate either hold periods beyond the four month statutory period or restrictions on the investors ability to transfer its securities. These restrictions, which were generally made subject to certain exceptions
such as tendering to a third party take-over bid, included prohibitions on resales for a set period of time and limitations on the manner in which resales may be made. For example, some investors agreed to resell shares only through broad marketed distributions whereas others agreed not to sell to competitors, customers or significant shareholders of the issuer.

Standstills

In five of the 11 reviewed transactions, the investor agreed to a standstill. The standstill period was based either on a fixed period of time or for so long as the investor owned a minimum percentage of the issuer's securities.

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Given the continued volatility in the capital markets and difficulty for some issuers to obtain debt financing, we have every reason to expect the popularity in PIPE transactions to continue in 2010.

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