CANADIAN CAPITAL MARKETS REPORT

LOOKING BACK, LOOKING AHEAD

2016

DAVIES

Canadian Capital Markets Report 2016

Looking Back, Looking Ahead

Davies Ward Phillips & Vineberg LLP is an integrated firm of approximately 240 lawyers with offices in Toronto, Montréal and New York. The firm is focused on business law and is consistently at the heart of the largest and most complex commercial and financial matters on behalf of its clients, regardless of borders.

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Overview

The past year was a roller coaster of a year for Canadian capital markets, beginning much how it ended – with a devalued Canadian dollar, lower interest rates in Canada and a shift in regional growth from the west to central Canada. Against the background of these market realities, the focus of the Canadian securities regulators for 2015 was to modernize regulation in an effort to improve the efficiency and integrity of Canadian capital markets.

We are pleased to provide you with an overview of some of the more notable developments in Canadian capital markets in the past year and to share with you our insights on those developments and their impact for 2016.

- The proposed "quasi-national" *Capital Markets Act* garnered significant attention again in 2015. Notwithstanding comments provided by Davies on a prior draft of the Act, the participating regulators continue to model the Act and regulations on the legislation of British Columbia, where the capital market comprises smaller issuers and which has historically faced very different securities regulatory issues than Ontario. This choice is difficult to defend on a principled basis and has led many to question The High Price of Cooperation: The Latest Capital Markets Act.
- In 2016, Canadian regulators announced the final adoption of previously proposed amendments to Canada's take-over bid regime. The new rules are designed to shift the balance of power between target boards and shareholders by extending the minimum bid period to 105 days and mandating a minimum 50% tender condition. Read more about the final rules in Take-over Bid Code Reset: 50-10-105.
- Five initial public offerings by Special Purpose Acquisition Corporations, or SPACs, were completed in 2015, raising over $1.1 billion. The continued viability of this asset class depends on SPAC sponsors finding suitable targets and, to date, no Canadian SPAC has completed a qualifying acquisition. Nonetheless, SPACs Have Arrived in Canada: Will They Stay?
- Canada has been waiting for decades for a modern, comprehensive regulatory regime for offshore offerings. In August 2015, regulators in British Columbia, New Brunswick, Ontario, Prince Edward Island, Saskatchewan and Yukon proposed a new offshore offering regime under the *Capital Markets Act*. Unfortunately, the proposal is the opposite of progress. Instead of moving forward with a modern approach in line with offshore regulation in other jurisdictions, Canada could be left with a Blast from the Past: Canada's Proposed Offshore Offering Rules Take a Step Back (in Time).

- After a long period of low activity, several issuers accessed Canadian capital markets in 2015 with dual-class share structures. Opponents of the structures argue that they are unfair, contrary to shareholder democracy and open to abuse. Others have argued that dual-class share structures are advantageous because they allow directors and management to focus on the long-term success and profitability of the company. Read more about these controversial yet popular structures in **Dual-Class Share Structures: A View from the North**.
- During 2015, Canadian securities regulators were busy finalizing and adopting many of their various initiatives relating to prospectus-exempt distributions, with a view to facilitating easier access to capital and strengthening investor protection. Although the recognition of the need to liberalize the exempt market is laudable, the resulting rules have left a disturbing lack of harmonization across jurisdictions. Read about the new and "improved" prospectus exemptions in **Overview of Exempt Market Developments**.
- Davies blew the whistle on the proposed *Whistleblower Program* published by the Ontario Securities Commission in early 2015. In our comments, we highlighted some flaws in the program, including the perverse incentives that financial rewards create and the inappropriate message that will be sent to the market if the OSC allows culpable individuals to receive whistleblower awards. Nonetheless, the regulator is intent on moving forward with **The Ontario Securities Commission's Proposed Whistleblower Program**.
- In 2015, rule amendments came into force that codified and replaced certain discretionary "wrapper relief" orders previously granted to various U.S. and Canadian securities dealers. The rule amendments also significantly expanded the scope of those relief orders and eliminated many lingering issues. As a result, the vast majority of U.S.-registered and non-registered offerings of "eligible foreign securities" can now be extended into Canada without the need for a Canadian wrapper. We have unwrapped these rule amendments in **New Wrapper Exemption Introduced**.
- As in Canada, securities regulators in the United States introduced several capital-raising and corporate governance initiatives in 2015. Our U.S. update, **Recent SEC Rulemaking Developments**, provides an overview of some of these initiatives that may affect Canadian issuers.

01 The High Price of Cooperation: The Latest *Capital Markets Act*

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The High Price of Cooperation: The Latest *Capital Markets Act*

The revised draft *Capital Markets Act* proposed to be enacted by the provinces and territory participating in the cooperative Capital Markets Regulatory Authority (the Authority) was published in August 2015. Davies submitted a comprehensive comment letter on the revised Act raising concerns over significant substantive changes to Ontario law, with an inadequate consultation process, and the Act's broad extraterritorial reach and adoption of sweeping regulatory powers and regulatory discretion.

Leading with the Wrong Foot

Many of our continuing comments and concerns flow from the initial decision made by the drafters of the legislation to model it on the British Columbia *Securities Act* (BC Act) and not on the Ontario *Securities Act* (Ontario Act). The Ontario Act governs the largest portion by far of Canada's capital markets, and Ontario has a vigorous and involved securities bar and investment community, both of which have contributed over the years to a robust dialogue on the evolution of securities legislation. This is evident in the comment process on the initial draft of the legislation, in which the vast majority of comments came from Ontario market participants. The choice to model the *Capital Markets Act* on the legislation of British Columbia, where the capital market comprises smaller issuers and which has historically faced very different securities regulatory issues than Ontario, is difficult to defend on a principled basis. By proceeding on the wrong foot from the outset, the drafters of the *Capital Markets Act* will impose legislation on Canada's key financial and capital markets that will be disruptive to well-established transaction mechanics and compliance practices and will impose significant costs on market participants to adapt to a new regime.

The choice to model the *Capital Markets Act* on the legislation of British Columbia is difficult to defend on a principled basis.

Substantive Changes Proposed Without Adequate Consultation

Although we view the achievement of consensus among the several participating jurisdictions as an accomplishment, we continue to have concerns over both the extent to which the *Capital Markets Act* introduces significant substantive changes into the law and the quality of the consultation process.

As we commented in our 2014 letter, the introduction of the new legislation should not be used as an opportunity to introduce major substantive changes to Ontario securities law unless the adoption of such changes is preceded by a thorough public consultation and study of the changes. We recommended at that time that the long-established process of the Ontario Securities

Commission and the Canadian Securities Administrators in this regard ought to be followed here. That would require each change to be identified in the request for comments, its implications explained and its necessity justified.

We appreciate the efforts of the participating jurisdictions to engage in a consultative process; however, we do not think the process was ultimately satisfactory. In many instances, where commenters provided thoughtful and detailed comments on the initial draft legislation, the response was simply to note that the draft was consistent with legislation in other jurisdictions without addressing the specific concerns raised. We do not consider that adequate justification for a change in law.

Extraterritorial Reach

The Act would regulate sales of securities by Canadian issuers to foreign investors, adopting a British Columbia approach that is both dated and impractical.

The *Capital Markets Act* significantly extends the extraterritorial reach of Canadian securities law. For example, the Act would regulate sales of securities by Canadian issuers to foreign investors, adopting a British Columbia approach that is both dated and impractical and will be an impediment to Canadian issuers' access to the United States and other international capital markets. By capturing these offerings as distributions and therefore subject to the prospectus, registration and other requirements of the *Capital Markets Act*, the Act will subject issuers to additional and potentially conflicting rules and will ultimately render these offerings more difficult and costly to implement, with no real corresponding benefit to the participating jurisdictions. This is another example of the participating jurisdictions electing to adopt the British Columbia approach to regulation without any justification for the fundamental shift in the approach prevailing in Ontario and other provinces.

The *Capital Markets Act* also extends its jurisdiction to Canadian corporations, partnerships and trusts listed only on foreign exchanges that have not sought and are not seeking to access Canadian capital markets. The Act will also apply the insider trading and tipping prohibitions extraterritorially, so that persons in a participating jurisdiction that trade in securities listed in public markets outside Canada may contravene the Act, even though the foreign publicly traded entity has no real and substantial connection to Canada. To extend the application of the insider trading and tipping prohibitions extraterritorially is particularly problematic when the conduct may be lawful in the foreign jurisdiction, a risk that is especially acute in the insider trading and tipping area in which Canada's laws are more stringent than those of the United States and other jurisdictions.

This extraterritorial approach to regulation is not only beyond the stated purposes of the *Capital Markets Act*, but is intrusive and costly to market participants and creates conflicting regimes.

Broad and Sweeping Powers

The *Capital Markets Act* gives broad and sweeping powers to the Authority. For example, the Authority can require directors, officers, promoters and control persons of an "issuer" to hand over any "information, record or thing" in their possession or under their control that relates to the administration or enforcement of capital markets laws or the regulation of capital markets. This power of the Authority extends not only to reporting issuers and market participants but to any person that has issued or proposes to issue securities, from the tiniest private entity to the largest publicly held one. No case has been made for the broadening of powers of the regulator to the point of divorcing these powers completely from the traditional focus of securities regulation – namely, public securities markets. The participating jurisdictions defended the power on the basis that it exists under the BC Act without providing an explanation as to the policy rationale for its inclusion.

Substantial Regulatory Discretion

The *Capital Markets Act* vests substantial discretion in the Authority. The Authority has significant power to designate persons as members of a "prescribed class" or to otherwise "prescribe circumstances" in which persons will become subject to the regulation of the Authority and the application of the *Capital Markets Act*. The circumstances in which the regulator may make such determinations are not clearly delineated in the legislation. For example, the Authority will be able to require all registrants to meet such standards "as may be prescribed". The Authority will have the power to require issuers to obtain a receipt for a "prescribed offering document" in addition to requiring a receipt for a prospectus. The Authority can also deem a person to have control over another person in any "prescribed circumstance". This vesting of substantial discretion in the Authority, coupled with the platform approach to the legislation itself (which leaves vast sections of the law to regulation), undermines one of the key features of a sound capital market – namely, stability and predictability in the legal and regulatory regime, which allows for transaction planning.

"Catch and Release" Approach to Regulation

It appears that the general bias of the drafters of the *Capital Markets Act* was to adopt the most expansive prohibition from existing provincial securities acts. By way of illustration, although Ontario law was seldom the reference point for the *Capital Markets Act*, the drafters did decide to follow Ontario's unique approach and regulate non-resident investment fund managers. In addition, a number of sections of the *Capital Markets Act* take a "catch and release" approach to regulation whereby conduct is prohibited or persons are caught within a class of regulated persons unless exempted by regulation. For example, the *Capital Markets Act* defines the term "market participant" broadly to catch a larger universe of persons and entities than does the Ontario Act and then contemplates exemptions by regulation from specific obligations applicable to market participants generally. As a general principle, we believe this is not an appropriate approach to securities regulation; nor is it consistent with the approach of the Ontario Act.

What We Haven't Yet Seen

Two critical pieces of the *Capital Markets Act* and the cooperative regime have not yet been exposed for comment. The first is the nature of the interface between the Authority and the non-participating jurisdictions. The quality of that interface is critical to the successful implementation of the new regime, and we would expect that a seamless interface will be a precondition to the implementation of the new regime. The second critical omission is the regulation of prospectus-exempt distributions. Over the course of the last 24 months, the Canadian securities regulators have made significant strides in harmonizing the rules regarding prospectus exemptions. Notwithstanding this progress, there continue to be differences in the regulation of exempt offerings among the participating jurisdictions. Unifying these rules across the jurisdictions will be important to ensure the efficiency of the exempt market.

Conclusion

It is critically important that the drafters of the *Capital Markets Act* get it right the first time. Once the legislation has been passed by the several participating provinces and territory, it will be exceedingly difficult to change. By proceeding on the wrong foot from the outset, the drafters of the Act ended up in the wrong place. We would urge the drafters to step back and rethink the wisdom of their approach. Even among those who have wholeheartedly endorsed a national, federal or cooperative securities regulator, the question is being asked: Is this too high a price to pay?

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Take-over Bid Code Reset: 50-10-105

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On February 25, 2016, the Canadian Securities Administrators (CSA) announced the final adoption of previously proposed amendments to Canada's take-over bid regime. The new rules are designed to shift the balance of power between target boards and shareholders by extending the minimum bid period to 105 days and mandating a minimum 50% tender condition.

The three main features of the rules are as follows:

- **50% Mandatory Minimum Tender Condition.** Bids must be subject to a mandatory tender condition requiring more than 50% of target securities held by persons other than the bidder to be tendered before the bidder can take up any securities under the bid.
- **10-Day Extension.** Once the minimum tender condition and other bid conditions have been met, bids must be extended for an additional 10 days to permit undecided shareholders to accept the bid.
- **105-Day Bid Period.** Bids must remain open for a minimum of 105 days unless either (i) the target board announces that it is reducing the bid period to a shorter period of at least 35 days, in which case the shorter period would apply to all contemporaneous bids; or (ii) the target announces a friendly transaction, in which case the minimum deposit period for all contemporaneous bids would be automatically reduced to 35 days.

The amendments to the take-over bid rules are largely as previously proposed on March 31, 2015. However, instead of lengthening the minimum bid period from the current 35-day period to 120 days, the final rules provide for a 105-day minimum bid period.

The shortening of the originally proposed 120-day bid period by 15 days is intended to allow for the compulsory acquisition provisions of various Canadian corporate statutes to continue to be available for unsolicited bids. Compulsory acquisition provisions of the *Canada Business Corporations Act* and other provincial and territorial business corporation statutes are only available where the bidder has acquired 90% of the shares subject to the bid within 120 days of the commencement of its bid. Had the minimum bid period not been shortened, it would have become impossible to use the compulsory acquisition provisions to squeeze out non-tendering shareholders. A bid period of 105 days will allow a successful bidder achieving less than 90% to extend its bid for a further 10-day period in an effort to reach 90% and still have five days to commence the compulsory acquisition process.

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Take-over Bid Code Reset: 50-10-105

More Time and More Leverage for Target Boards

The CSA's rebalancing efforts will make bids more challenging for hostile bidders.

The CSA's rebalancing efforts will make bids more challenging for hostile bidders. Under current rules and practice, the minimum bid period is 35 days and any shareholder rights plan, or "poison pill", that the target might adopt to fend off a hostile bidder is routinely dismantled by securities regulators within 45 to 70 days of bid commencement.

The new 105-day period will give target boards a significantly longer period of time to evaluate a bid, seek alternatives or make the case for rejection of a bid. This period also provides a greater degree of predictability for a target board and its advisers to establish a strategic process, providing a fixed period of time, as opposed to the variable and shorter durations that securities commissions have allowed poison pills to last.

By giving target boards control over the ability to shorten the 105-day bid period, the new rules will give interested bidders a greater incentive to negotiate with target boards, rather than taking their offer directly to shareholders. A short bid period is typically key to limiting interloper risk. Under the new rules, bidders will have to bargain with the target to get that benefit, giving target boards the opportunity to negotiate for price and other concessions in return.

Power to the Collective

The new rules facilitate a form of collective shareholder decision-making in response to a bid, a marked departure from the current regulatory policy of protecting the rights of shareholders to make individual decisions to tender.

The requirement for a 50% minimum tender condition will prevent shareholders from selling to a bidder if the bid is not supported by a majority of the target shareholders. In the past, hostile bidders would typically reserve the right to waive their own self-imposed minimum tender condition. This meant that even if a bidder was unsuccessful in achieving a targeted majority of shares, it might seize the opportunity to become a significant minority shareholder (*e.g.*, 40% owner) by waiving its minimum tender condition and thus achieve a blocking position. This tactic was employed in Carl Icahn's hostile bid for Lions Gate Entertainment, in which Icahn waived his minimum tender condition in order to acquire 13.2% of the outstanding shares, giving him a 31% ownership block. Under the new rules, Icahn would have been prevented from acquiring any shares under his bid because a majority of Lions Gate shareholders had declined to tender.

The rule changes will also make partial bids more difficult. Even if a bidder is not seeking to acquire majority ownership of the target, the 50% minimum tender condition will apply – meaning that a majority of shareholders will have to be willing to sell a portion of their shares to the bidder.

The Future of Poison Pills?

The new rules do not address the continued use of poison pills. In its release accompanying the new rules, the CSA confirms that it has decided not to amend the existing policy on defensive tactics (National Policy 62-202). However, the CSA warns that it is prepared to examine the actions of target boards in light of the amended bid regime to determine whether they are abusive of securityholder rights. Given the significant extension of the minimum bid period, we expect that the use of shareholder rights plans to further postpone take-up by a hostile bidder will be met by swift intervention from securities regulators.

Rights plans will of course continue to be relevant to restrict shareholders from accumulating large positions through transactions that are exempt from the take-over bid rules. Consequently, boards wary of shareholders making "creeping" acquisitions of control through the private agreement purchase exemption and other take-over bid exemptions will still find utility in shareholder rights plans.

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Securities Commissions' Focus to Turn to Other Defensive Tactics

Although routine pill hearings in the context of hostile bids are likely a thing of the past, the new 50% minimum tender condition will result in greater scrutiny of other defensive tactics, particularly private placements of equity securities. The minimum tender requirement will give shareholders holding significant blocks of shares great influence over the success of a bid. In many cases, a single minority shareholder or a control block holder could effectively block another bid from proceeding. The potential for large blocks of shares to make the satisfaction of the minimum tender condition more difficult, or to block a bid from proceeding altogether, is likely to result in continued securities commission involvement in hostile bids.

Although intervention on defensive private placements is clearly contemplated under National Policy 62-202, Canadian securities regulators have stated that abusive conduct is the threshold for exercising their jurisdiction to intervene in a private placement. A review of a private placement requires examining the true motivations of a target, considering whether capital was in fact required, questioning whether that capital was raised in an appropriate manner and assessing the impact of the placement on the success of a bid. In contrast to the nature of the inquiry in typical poison pill hearings, these are tougher inquiries concerning more nuanced issues for securities commission tribunals to consider.

The final rules are expected to come into force on May 9, 2016. In Ontario, the effective date will depend on the proclamation into force of amendments to the *Securities Act* (Ontario).

03

SPACs Have Arrived in Canada: Will They Stay?

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One of the biggest developments in the Canadian capital markets in 2015 was the emergence of the Special Purpose Acquisition Corporation, or SPAC. Five SPAC initial public offerings (IPOs) were completed last year, raising over $1.1 billion – decades after the emergence of SPACs in the United States and more than six years after the Toronto Stock Exchange (TSX) adopted SPAC rules.

The deals started in April with Dundee Acquisition Ltd. raising $112 million. That was followed by offerings by INFOR Acquisition Corp. ($230 million), Alignvest Acquisition Corporation ($259 million), Acasta Enterprises Inc. ($403 million) and Gibraltar Growth Corporation ($105 million). Avingstone Acquisition Corporation and Kew Media Group Inc. also filed preliminary prospectuses but have not been able to close their offerings within the usual timelines.

A SPAC, often referred to as a "blank cheque company", is a publicly traded shell corporation with no operating business. Under the TSX rules, it is required to raise a minimum of $30 million through an IPO and place at least 90% of the offering proceeds in escrow. The SPAC must use these funds to complete a qualifying acquisition within 36 months, although most deal structures have a shorter period of 24 months. To qualify, the SPAC must acquire one or more operating businesses having an aggregate fair market value of at least 80% of the escrowed funds. If a deal is not completed, investors get their money back.

Why Invest in a SPAC?

Given that investors are making what is effectively a blind investment, the quality and reputation of the sponsors are critical. Canadian deals have featured such well-known names as David Goodman, Neil Selfe and Anthony Melman. SPACs have received strong institutional support, but they also appeal to retail investors seeking opportunities to make investments similar to those in private equity but with the liquidity of a TSX-listed security. Like the sponsors, regular investors receive warrants in addition to their shares, which provide additional potential upside.

Investor safeguards also provide important downside protection. A qualifying acquisition must be approved by a majority of shareholders and there are a number of structural off-ramps that permit investors to exit with their pro rata share of the escrowed funds, plus interest. This is the result for all investors if a qualifying acquisition is not completed within the required period. An investor may also choose to redeem his or her shares if the shareholders approve a qualifying acquisition, regardless of how the investor votes. Investors who redeem their shares will still be able to retain their warrants.

What Attracts Sponsors to SPACs?

SPACs are an efficient and flexible means for sponsors to access the public capital markets. SPACs may focus on a particular sector and geographical area, but the majority of Canadian SPACs to date have adopted a generalist approach. Sponsors receive shares and warrants, and will typically have a post-IPO ownership position of about 20% of the outstanding equity on a fully diluted basis. The sponsors provide at-risk seed capital to cover underwriting and other fees that are payable during the period up to the qualifying acquisition. To compensate them for this risk, most of their shares are acquired at a nominal cost, providing significant upside potential. In a liquidation scenario, sponsors are not permitted to participate in the distribution of escrowed funds and will lose their initial investment.

Who Wants to Be Acquired by a SPAC?

A SPAC transaction may be particularly appealing during periods when market conditions cause other M&A and IPO options to be unavailable.

Targets acquired by SPACs are predominantly privately owned businesses that are looking to be sold or to go public without undertaking the considerable effort and expense of a reverse take-over or a traditional IPO. A SPAC transaction may be particularly appealing during periods when market conditions cause other M&A and IPO options to be unavailable. A SPAC also offers an existing shareholder base and an experienced board that may add significant value to a private business seeking to grow and execute its business plan in a public market context.

However, SPACs have particular challenges in executing M&A transactions. To comply with the TSX rules, SPACs must navigate a complex and lengthy process that includes clearing with securities regulators a non-offering prospectus containing *pro forma* and target company financial statements, pre-clearing a proxy circular with the TSX and obtaining majority approval at a duly called shareholders' meeting. In an auction process, SPACs are at a distinct disadvantage to other potential purchasers who are capable of executing quickly, such as traditional private equity funds.

This long execution timeline has also provided an opportunity for hedge funds to engage in arbitrage activities, which may involve strategies that work against the closing of an acquisition. The TSX now permits SPACs to limit redemptions by any single shareholder and its joint actors to 15% of the outstanding shares, limiting activist shareholders from acquiring large positions and relying on redemption mechanics to affect the acquisition process.

What's Next for SPACs in Canada?

Investors embraced the SPAC investment model in 2015, although that enthusiasm may have waned as evidenced by the uncertain status of the SPAC offerings later in the year by Avingstone and Kew Media. More important, the viability of this asset class depends on SPAC sponsors finding suitable targets and executing qualifying acquisitions. To date, no Canadian SPAC has completed a qualifying acquisition. Investors will be watching closely in 2016.

It will also be interesting to see if Canadian SPACs that are able to complete a qualifying acquisition can generate returns over the long term that meet the expectations of investors. Despite being well established in the United States, SPACs as a group have not consistently generated strong returns. According to SPAC Analytics (http://www.spacanalytics.com), of the 130 U.S. SPACs created between 2003 and 2015 that completed an acquisition, the median annualized return was -15.2%. Time will tell if Canadians can do better.

To date, no Canadian SPAC has completed a qualifying acquisition. Investors will be watching closely in 2016.

04

Blast from the Past: Canada's Proposed Offshore Offering Rules Take a Step Back (in Time)

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Blast from the Past: Canada's Proposed Offshore Offering Rules Take a Step Back (in Time)

Canada has been waiting for decades for a modern, comprehensive regulatory regime for offshore offerings. Canada's offshore offering regulation is unclear, incomplete and inconsistent across the country. Despite substantial progress in updating and harmonizing domestic securities laws, Canadian securities regulators have left offshore offering regulation untouched. In August 2015, regulators in British Columbia, New Brunswick, Ontario, Prince Edward Island, Saskatchewan and Yukon proposed a new offshore offering regime under the *Capital Markets Act*. Unfortunately, the proposal is the opposite of progress. Instead of moving forward with a modern approach in line with offshore regulation in the United States and other foreign jurisdictions, the regulators took a step back by adopting British Columbia's antiquated, extraterritorial "distribution out" approach.

The proposed distribution-out approach has been criticized as a "catch and release" regime, requiring exceptions to address the many negative, unintended consequences from casting such a broad net. Because it is impossible to foresee and properly address all of these consequences, this proposed approach is like fishing with dynamite. It will be disruptive, costly and, in many circumstances, unworkable. Moreover, it serves no purpose. Canadian securities regulators have many tools to police misconduct that, despite being offshore, threatens the integrity of Canadian capital markets. Requiring a Canadian prospectus for an offshore offering is not one of those tools.

The proposed distribution-out approach has been criticized as a "catch and release" regime ... it is like fishing with dynamite.

The Current Regime: A "Retro-Perspective"

In Canada, the distribution concept is used to identify trades in securities for which a prospectus (or a prospectus exemption) is necessary. An offering by an issuer is the most obvious example; however, the resale of previously issued securities by a control person or within a hold period may also be a distribution. The term "distribution" is broadly defined without express limitation on its territorial scope. Mindful of this omission in the law, Canadian securities regulators have published policy statements to clarify when offshore offerings might constitute a distribution. Unfortunately, these policies are unclear and incomplete, and vary widely, with the Ontario and B.C. regimes demonstrating how divergent they can be.

The Ontario regime for regulating offshore offerings applies a "distribution in" test – an offering is a distribution only if made to investors in Ontario or, due to certain connecting factors with Ontario, there is a reasonable likelihood that the offered securities will flow back into Ontario without first coming to rest outside the province. In addition to a distribution-in test, British Columbia also applies a "distribution out" test, which provides that any offering from British Columbia is also a distribution. B.C. regulators deem an offshore offering to be *from* British Columbia if the issuer has certain substantial connections to the province, such as having its mind and management primarily located within, or conducting its business from, the province. Most of these connecting factors have no bearing on flowback risk.

This stark contrast between the Ontario and B.C. regimes is due to fundamentally different views about the purpose of the prospectus requirement in the different jurisdictions. While unclear, the B.C. approach suggests certain Canadian-specific prospectus protections should be afforded to all investors, regardless of their location, if they acquire securities from an issuer with substantial connections to British Columbia. In contrast, the Ontario regime properly affords Canadian-specific prospectus protections only to investors located in Ontario, recognizing that investors outside the province will be entitled to the substantive and procedural protections afforded to them under the securities legislation of the jurisdiction in which those foreign investors are located.

Inexplicably, in designing the offshore offering regulations for the *Capital Markets Act*, regulators chose the B.C. regime. The Ontario regime is far from perfect, but it is a better starting point. Much like a CD player, the Ontario regime was a reasonably current approach in the early nineties that, in principle, can still work today. However, by failing to clearly account for modern advances in Canadian and global capital markets, the Ontario regime can impede certain legitimate capital-raising and investing activities. By comparison, the B.C. regime is as obsolete and incompatible as an eight-track cartridge player. It is modelled on an antiquated U.S. regulatory regime that U.S. regulators subsequently determined unworkable (due to its broad extraterritorial application) and, in 1990, superseded through a series of rules referred to as Regulation S.

The Regime Proposed for the *Capital Markets Act*: No Steps Forward, Two Steps Back (in Time)

It is difficult to grasp the purpose of the proposed distribution-out approach. This will require an issuer to file a Canadian prospectus with respect to a foreign offering (or fit within an exemption to the prospectus requirement) merely because the issuer has a substantial business or other connection to the regulating jurisdiction. The filed Canadian prospectus is not intended to afford Canadian investors acquiring any such flowback securities the disclosure and other protections of a Canadian prospectus. Nor would (or should) the Canadian prospectus afford the initial foreign investors those Canadian-specific prospectus protections – the jurisdiction in which a foreign investor is located should govern the disclosure and other protections provided to that investor. Foreign investors participating in the offering would not even receive a copy of the Canadian-filed prospectus.

The regulators have not articulated any purpose or benefit to their proposed distribution-out regime except that, in their view, it is necessary "from both reputational and accountability standpoints". While protecting the integrity of Canadian capital markets is an appropriate objective, that objective is properly and adequately addressed through other Canadian securities law requirements – not the prospectus requirement. Applying Canadian prospectus requirements to a bona fide offshore offering serves no purpose, is costly and can conflict with the applicable foreign disclosure and marketing requirements and practices.

Applying Canadian prospectus requirements to a bona fide offshore offering serves no purpose.

To mitigate issues arising from its unnecessarily broad approach, the *Capital Markets Act* includes a proposed exemption for offerings made exclusively offshore. Unfortunately, this exemption is wholly insufficient, imposing a number of limitations and conditions that are not workable and have no clear policy objective. Among its critical flaws is the imposition of transfer restrictions on securities distributed under the exemption. These transfer restrictions are unworkable in the context of a public offshore offering because the offered securities would not be fungible with the outstanding class and could not be traded over the relevant exchange. Further, a number of issuers could not use the exemption because it is available only to issuers with equity securities listed on certain specified exchanges in Canada, the United States and the United Kingdom. The exemption also requires the issuer to file a post-trade report with personal information of foreign resident purchasers. This reporting entails additional administrative burden for no purpose and raises a number of issues, including potential concerns under foreign privacy legislation. Notably, there is no equivalent reporting requirement with respect to purchasers in a Canadian prospectus offering.

Our Solution: Bring Canada Back to the Future

In our submissions on the *Capital Markets Act*, we urged the regulators to adopt a modern, comprehensive, national framework for governing offshore offerings. Central to our proposed framework is an express, overriding principle along the lines of the distribution-in approach – that is, an offering or other trade is not a "distribution" if made outside Canada. A trade that is not a distribution is not subject to Canadian prospectus requirements, and the traded securities should be freely tradable back into Canada (unless held by a control person). Ideally, this framework should be established through law — not policy — since it demands a level of transparency and certainty that cannot be achieved exclusively through policy statements.

While policy can (and should) provide guidance on factors that bear on whether an offer is made outside Canada, capital markets participants require clear standards to properly govern their affairs for common cross-border trades. This can be accomplished through safe harbours that deem a trade to be made outside Canada if objective tests are satisfied so that it is likely that the traded securities will come to rest outside Canada (*e.g.*, in the case of equity securities, the majority of trading volume is outside Canada), or if specified offering restrictions are implemented (such as a hold period on trading back into Canada) to provide reasonable assurance of this. Likewise, there should be a safe harbour for a bona fide offshore resale of securities initially subject to a hold period – for example, an ordinary trade of those securities over a foreign exchange without knowledge that the purchaser is Canadian.

Our solution will afford capital markets participants clear standards to properly govern their affairs for common cross-border trades.

A comprehensive framework must also accommodate bona fide public offerings outside Canada that pose a flowback risk and, as a result, are still distributions for Canadian securities law purposes. Securities initially issued to foreign investors in those offerings should also be freely tradable back into Canada. This gap could be addressed by allowing an issuer to file a Canadian prospectus to qualify its offshore offering without delivering a copy to foreign investors or affording those investors other associated Canadian prospectus protections. Alternatively, the gap could be addressed through a prospectus exemption to avoid the inefficiency and other potential issues associated with filing a Canadian prospectus that is of no benefit to investors.

Our proposed framework for governing offshore offerings is consistent with the offshore offering regulation that has been successfully applied in the United States for over 25 years. Older approaches are obsolete and conflict with advances in modern Canadian and global capital markets practices. In our view, Canadian regulators should leave outdated regulatory schemes in the past and bring Canada's offshore offering regulation back to the future.

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Dual-Class Share Structures: A View from the North

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Some factions of the investment community and academics have begun to bemoan the so-called comeback of the dual-class share structure. After a long period of low activity, with several years of zero to a handful of non-resource-based IPOs in Canada, several issuers have come to market recently with dual-class share structures. Notable examples are BRP Inc. (Bombardier Recreational Products), Stingray Digital Group Inc., Cara Operations Ltd. and Shopify Inc. The IPOs of Google Inc., Facebook Inc. and Groupon Inc. in the United States make the emphatic point that this is not just a Canadian phenomenon. More than 13.5% of the 133 companies that listed on U.S. exchanges in 2015 had dual-class share structures – up from 12% in 2014 and just 1% in 2005.

Historically, some commentators in the investment community and governance groups have expressed concerns that companies with dual-class share structures lacked appropriate corporate governance policies and had disenfranchised shareholders. However, dual-class share structures have been shown to produce some benefits. They can have a positive impact on executive decision-making, company performance and the accessibility of certain investments to the public. They can also provide a means for some companies to combat detrimental or unwanted investor activism.

There have been some recent developments in Canada regarding dual-class share companies. For example, in May 2015, BMTC Group Inc. collapsed its dual-class share structure, with all shareholders being converted into one class. There were market rumours of Bombardier Inc. doing so as well in connection with provincial government financing it received, but that did not take place. Those stories have resurfaced in the news in the context of federal financing discussions. In June 2015, Fairfax Financial Holdings Inc. increased the votes attached to its multiple voting shares to 50, from 10, in conjunction with amendments to certain of its governance practices. Its dual-class structure is now subject to shareholder ratification if the number of shares of the multiple voting class increases above a certain level. Alimentation Couche-Tard Inc. proposed a change to its sunset provisions, but ultimately removed the proposal from the agenda for its annual shareholders' meeting.

Opponents of the structures argue that they are unfair, contrary to shareholder democracy and open to abuse.

What's the Concern?

Opponents of the structures argue that they are unfair, contrary to shareholder democracy and open to abuse. In 2013, the Canadian Coalition for Good Governance published recommendations on best practices for dual-class issuers, including a maximum 4-to-1 vote ratio, a limit on the number of directors who can be elected by holders of multiple voting shares and prohibitions on the ability of multiple voting shareholders to receive a premium for collapsing

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the structure. A number of these recommendations were and continue to be supported by some significant institutional investors.

Recognizing some of the risks associated with these structures, the Toronto Stock Exchange (TSX) long ago implemented "coattail requirements" aimed at reducing change of control concerns raised by holders of subordinate voting shares.

Institutional investors and indexed funds represent a large percentage – up to 60% – of the trading of dual-class issuers on Canadian stock markets.

Calls for increased regulation – or even abolition – of dual-class share structures are based on concerns of unfair treatment of the investing public. However, institutional investors and indexed funds represent a large percentage – up to 60% – of the trading of dual-class issuers on Canadian stock markets. Opponents of dual-class share structures must accept that these investors make informed investment decisions. Is this protectionist view necessary even for retail investors? Under Canadian law, public companies are required to provide investors with information that would affect a reasonable person's investment decision, and directors are required to make decisions that are in the best interests of the company itself, without regard to the interests of any particular shareholder.

What Are the Benefits?

There are good reasons why people invest in companies with dual-class structures. These share structures can prevent investors from bullying corporate decision-makers into sacrificing genuine opportunities in order to boost near-term stock prices. They can allow corporate directors and management to focus on the long-term success and profitability of the company, rather than on satisfying shareholders' short-term financial expectations at the expense of building long-term value.

Entrepreneur-controlled companies may also be encouraged to access the public capital markets by using dual-class share structures, without which they may decide not to do so. Some studies have shown that companies controlled by a founder or family group often perform better than widely held companies because management can focus on the business from a longer-term perspective.

The Practical Result

Investors are obviously free to choose whether or not to invest in dual-class companies. There is no shortage of companies with traditional share structures that may be equally attractive investment destinations. It appears, however, that investors want to invest in these dual-class structures.

From a Canadian perspective, there seems to be sufficient protection for investors in the form of TSX coattail provisions, securities law disclosure requirements and corporate law. Although it certainly makes sense to take a critical look at the structures to ensure that they are being used appropriately, there is no use shouting at the rain. Like it or not, the reality is that dual-class share structures are unlikely to disappear anytime soon – and for good reason: people keep investing! Some investors, at least, seem willing to be somewhat disenfranchised in exchange for the opportunity to profit from an exciting company's success.

06 Overview of Exempt Market Developments

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Overview of Exempt Market Developments

During 2015, Canadian securities regulators were busy finalizing and adopting many of the fruits of their various initiatives relating to prospectus-exempt distributions. The focus of these initiatives was to facilitate easier access to capital for small and medium-sized businesses and strengthen investor protection. To this end, securities regulators in one or more Canadian jurisdictions have adopted new rules or have amended existing rules relating to exempt distributions to: accredited investors; purchasers of a minimum value of securities ($150,000); existing shareholders; family, friends and business associates; investors who receive suitability advice from an investment dealer; and investors who receive a prescribed form of offering memorandum. Canadian securities regulators also revised the short-term debt exemption to create a separate exemption for short-term securitized products such as asset-backed commercial paper. In addition, there are now two separate crowdfunding exemptions available in certain Canadian provinces, with a third regime proposed by regulators in Alberta and Nunavut. However, not all these exemptions are available in all jurisdictions and, even for prospectus exemptions with a national scope, embedded differences remain in the applicable rules across various jurisdictions.

Easier Access to Capital

The main beneficiaries of the new regimes will likely be smaller public issuers, because several of the new and modified exemptions are available only to listed issuers and investment limits in certain exemptions render them impractical or inefficient for use by larger issuers. Larger public issuers will benefit most from the new streamlined rights offering exemption, as the maximum permitted dilution has been increased to 100% and securities commission review has been eliminated with a view to reducing the time required to effect a prospectus-exempt rights offering.

Increased Investor Protection

Investors will also benefit from measures implemented to increase investor protection. Some of the new or modified exemptions – such as the revised rights offering exemption, the existing shareholder exemption and the suitability advice exemption – grant investors the same rights that are available to purchasers in the secondary market under civil liability provisions of securities legislation. The result is that investors will have a right of action in respect of misrepresentations contained in the issuer's continuous disclosure record at the time of the investment. This innovation not only protects investors on the basis of the current market information available regarding the issuer, but also obviates the need to prepare offering-specific disclosure regarding the issuer itself.

The other major investor protection trend is the extended requirement for signed risk-acknowledgement statements. For instance, the revised accredited investor exemption now requires that certain individuals who qualify as accredited investors complete a risk acknowledgement form in order to use the exemption. Our view is that the additional investor protection provided by a risk acknowledgement is negligible; however, we have noticed that the new requirement has already resulted in individuals who are accredited investors being excluded from certain offerings.

Although the recognition of the need to liberalize the exempt market regime is laudable, the resulting rules have left a disturbing lack of harmonization across jurisdictions.

Lack of Harmony

Although the recognition of the need to liberalize the exempt market regime is laudable, the resulting rules have left a disturbing lack of harmonization across jurisdictions. For instance, the offering memorandum exemption, which is now available across the country, contains four different regimes governing maximum permitted investment and three different sets of ongoing disclosure requirements, depending on which jurisdiction's laws govern the investor. Similarly, the family, friends and business associates exemption adds further separate requirements for those raising capital in each of Saskatchewan and Ontario. These differences across jurisdictions and their incremental cost and compliance requirements may also serve as an impediment to capital formation. Interestingly, many of the differences arise between the six jurisdictions that have agreed to join the cooperative Capital Markets Regulatory Authority, which may explain the delay in the publication of rules regarding exempt distributions under the proposed *Capital Markets Act*.

Summary of Exemptions

Highlights of the new and revised rules that have emerged from the various exempt market reviews include the following.

ACCREDITED INVESTOR EXEMPTION/MINIMUM AMOUNT ($150,000) EXEMPTION

- Financial thresholds unchanged
- Minimum amount exemption no longer available to individuals
- Most accredited investors who are individuals required to execute a risk acknowledgement form

RIGHTS OFFERING EXEMPTION

- Elimination of pre-launch document review by securities commission expected to significantly reduce time required to complete exempt rights offering (though stock exchange approval still necessary)
- Available only to reporting issuers
- Maximum permitted dilution increased to 100%
- Disclosure requirements streamlined
- Right of action available based on the issuer's continuous disclosure

EXISTING SECURITYHOLDER EXEMPTION

- Ontario adopts
- Available to issuers on TSX, TSX Venture, Canadian Securities and Aequitas NEO exchanges for distributions of listed securities or units to existing holders
- Investors limited to purchases of $15,000 unless suitability advice received from registered investment dealer
- Offering to be made available to all securityholders and "fairly allocated" among investors (no *pro rata* requirement)
- Right of action available based on the issuer's continuous disclosure

OFFERING MEMORANDUM EXEMPTION

- Ontario adopts
- Ontario's exemption features, and five other provinces will be amended to include
    - new financial limits on purchases, depending on nature of investor
    - certain ongoing disclosure requirements for non-reporting issuers that use the exemption, including regarding financial statements
    - regimes regarding the use of marketing materials

FAMILY, FRIENDS AND BUSINESS ASSOCIATES EXEMPTION

- Ontario approaches harmonization with other jurisdictions: founder, control person and family exemption extended to "close personal friends" and "close business associates" of a director, an executive officer or a control person of the issuer or an affiliate of the issuer

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Overview of Exempt Market Developments

SUITABILITY ADVICE EXEMPTION

- Adopted in British Columbia, Alberta, Saskatchewan, Manitoba and New Brunswick, but not Ontario
- Available to issuers on TSX, TSX Venture, Canadian Securities and Aequitas NEO exchanges for distributions of listed securities, units of listed securities and warrants and securities convertible into the listed security at the holder's discretion
- Investor must have received suitability advice from a registered investment dealer
- No investment limits
- Right of action available based on the issuer's continuous disclosure

CROWDFUNDING

- MI 45-108 adopted in Ontario, Québec, Manitoba, New Brunswick, Nova Scotia and, pending ministerial approval, Saskatchewan
- Substantially harmonized rules adopted in Québec, Manitoba, New Brunswick and Nova Scotia for start-up crowdfunding
- MI 45-109, a separate crowdfunding regime, published for comment by Alberta and Nunavut (initial comment period closed December 18, 2015)

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The Ontario Securities Commission's Proposed Whistleblower Program

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On October 28, 2015, the Ontario Securities Commission (OSC) published for comment its Proposed OSC Policy 15-601 – *Whistleblower Program*. This program (Proposed Whistleblower Program) shares many similarities with the whistleblower program introduced by the United States Securities and Exchange Commission under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* in 2010.

If adopted, the Proposed Whistleblower Program would establish a whistleblower regime for reporting securities-related misconduct directly to the OSC, which, among other things, would provide financial rewards to whistleblowers if enforcement is successful. The purpose of the Proposed Whistleblower Program is to assist the OSC with identifying and investigating violations of Ontario securities laws, particularly in matters involving financial reporting and disclosure, insider trading and market manipulation.

Anonymous and Culpable Whistleblowers Permitted

Under the Proposed Whistleblower Program, individuals would be permitted to report alleged violations of Ontario securities laws anonymously. It would also permit individuals who are complicit in the violation of Ontario securities laws to receive a monetary award for reporting such conduct, although the degree to which a whistleblower is complicit in the conduct may decrease the amount of any monetary award that may be made to that individual.

Significant Features

The Proposed Whistleblower Program would operate separately from internal compliance policies adopted by reporting issuers. Under the Proposed Whistleblower Program, the OSC would not require the whistleblower to report the information internally as a first step. Once the whistleblower reports a matter to the OSC, he or she would be prevented from subsequently reporting on such matter to the reporting issuer in question.

Some other significant features of the Proposed Whistleblower Program are as follows:

- **Qualifying as a Whistleblower.** A reporting issuer's employees would be eligible to receive a "whistleblower award" under the Proposed Whistleblower Program, as would third-party individuals. Directors, officers (including chief compliance officers or equivalents), internal and external auditors and legal counsel (in-house and external) are also eligible under more limited circumstances. As previously noted, culpable individuals would not automatically be excluded from qualifying as whistleblowers; however, the level of culpability would be a relevant consideration in determining the amount of the award, if any.

- **Quality of the Information.** The OSC would be seeking timely, credible and robust information, with well-organized supporting documentation. Information provided by a whistleblower must be original and not already known to the OSC. The informational requirement of the Proposed Whistleblower Program will likely be at odds with an employee's confidentiality obligations to a reporting issuer; however, any such breach would be protected under the anti-retaliation measures in the Proposed Whistleblower Program.
- **Confidentiality of Whistleblower's Identity and Anonymity.** Reasonable efforts would be made to keep the identity of the whistleblower confidential, with certain exceptions. In addition, a whistleblower represented by counsel would be permitted to submit a complaint to the OSC anonymously if the individual meets the conditions for doing so. However, an anonymous whistleblower would generally be required to confirm his or her identity as a condition to receiving a monetary award for information provided to the OSC.
- **Anti-Retaliation.** The OSC is proposing to implement anti-retaliation measures to deter employers from retaliating against employees who provide information internally or to the OSC. OSC staff would have the authority to prosecute any such retaliatory action under the public interest provisions of the *Securities Act* (Ontario).
- **Financial Incentive.** Upon a successful enforcement order or settlement that results in monetary sanctions or a voluntary payment of C$1 million or more, a whistleblower would be eligible to receive a monetary award of between 5% and 15% of the total monetary sanctions imposed and/or voluntary payments made, to a maximum of C$1.5 million. In more limited circumstances, including where payment collected exceeds C$10 million, a whistleblower may receive up to a maximum of C$5 million. As noted above, a whistleblower who is complicit in the violation may be eligible for an award. The degree to which the whistleblower is complicit is a factor that may decrease the amount of any whistleblower award that may be made.

Potential Red Flags for Reporting Issuers

Certain of the structural aspects of the Proposed Whistleblower Program may raise a red flag for reporting issuers who have already established a robust whistleblower program. For example, the creation of financial incentives for whistleblowers may ultimately deter employees from reporting issues internally. In addition, the proposed monetary incentives built into the program are linked to the size and imposition of monetary penalties and could therefore discourage early reporting by the whistleblower due to the possibility of making a larger reported violation and receiving a higher monetary award.

The creation of financial incentives for whistleblowers may ultimately deter employees from reporting issues internally.

How to Get Prepared

It would be premature for reporting issuers to revise their whistleblower policies in advance of the OSC's publication of the final Proposed Whistleblower Program, expected in spring 2016. However, it is likely that the OSC will implement the Proposed Whistleblower Program, either in the form of the published draft or revised to address concerns raised to date by industry participants and other commentators. Accordingly, reporting issuers should consider additional steps to enhance the culture of openness and robust internal reporting at their organizations, including highlighting the availability and effectiveness of their existing whistleblower policies. In addition, the board of directors and management of reporting issuers should consider reviewing internal controls and reporting systems and confirm readiness in the event of an OSC investigation.

08
New Wrapper Exemption Introduced

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On September 8, 2015, rule amendments came into force that codified and replaced certain discretionary "wrapper relief" orders granted to various U.S. and Canadian securities dealers in 2013. The rule amendments also significantly expanded the scope of those relief orders and eliminated many of the lingering issues created by those orders. The result is that the vast majority of U.S. registered and non-registered offerings of "eligible foreign securities" can now be extended into Canada using only the U.S. offering document without the need for a Canadian "wrapper".

Summary of the Amendments

Broadly speaking, the amendments created an exemption from each of the Canadian securities regulations that previously necessitated the preparation of a Canadian wrapper – namely, the requirement to provide (i) underwriter conflict-of-interest disclosure that complies with Canadian rules and (ii) lengthy disclosure regarding the availability of statutory rights of action.

In general, the "wrapper exemption" – as it has become known – is available if all of the following conditions are met:

- The offering is conducted primarily in a foreign jurisdiction.
- The security being distributed is either
    - issued by an issuer that (i) is incorporated, formed or created under the laws of a foreign jurisdiction; (ii) is not a reporting issuer anywhere in Canada; (iii) has its head office outside Canada; and (iv) has a majority of its executive officers and directors ordinarily resident outside Canada; or
    - issued or guaranteed by the government of a foreign jurisdiction.
- All the purchasers in Canada are "permitted clients" (in general, Canadian financial institutions, companies with net financial assets of at least $25 million or individuals with net financial assets of at least $5 million).
- The offering document delivered to Canadian purchasers complies with U.S. disclosure requirements regarding underwriter conflicts of interest, including, where applicable, FINRA rule 5121.
- The offering document contains certain prescribed language to the effect that the seller is relying on an exemption from the applicable Canadian rules (or a one-time notice delivered to the Canadian investors in advance of the offering).

Notably, sellers are no longer required to obtain signed "consent and acknowledgements" from prospective purchasers before the exemption can be relied upon. The removal of this burdensome administrative requirement is a significant improvement over the wrapper relief orders. In addition, whereas a wrapper relief order was available only to a person that applied for it, the statutory wrapper exemption is available to everyone – issuers and dealers alike.

Multilateral Instrument 51-105 Considerations

Multilateral Instrument 51-105 – *Issuers Quoted in the U.S. Over-the-Counter Markets* (MI 51-105) – was adopted in July 2012 in all Canadian jurisdictions except Ontario. It created a number of technical problems for issuers distributing securities into Canada if they had no securities listed on certain designated exchanges, including the NYSE and Nasdaq. However, as a result of blanket relief orders issued in Québec, British Columbia, Alberta, Nova Scotia, Saskatchewan, New Brunswick and Yukon, in general, MI 51-105 does not apply in those jurisdictions to any distribution that is eligible to rely on the new statutory wrapper exemption. If the offering must be extended into other provinces or territories, consideration should be given to whether MI 51-105 may apply to the distribution. We understand that most of the remaining provinces and territories are working on issuing similar blanket orders in the near future.

No Change to Post-Trade Reporting Regime

Although the amendments create an exemption from the wrapper requirement in the circumstances described above, there is no change to the requirement to prepare and file a post-trade report and to pay the prescribed filing fees, in each case, within 10 days of the distribution date.

Other Considerations

Although the new wrapper exemption has been extremely well received by affected market participants, there continue to be circumstances in which it is necessary or desirable to involve Canadian counsel in an offering that is being extended into Canada. For example, the wrapper exemption may not be available, or other Canadian legal requirements may come into play, in the following circumstances:

- The issuer is a reporting issuer or the issuer or a selling securityholder has a significant connection to Canada.

- The issuer is or may be an "investment fund".
- The issuer is a limited partnership.
- The issuer is or may be a bank or financial institution and is selling debt securities.
- There is a directed share program or reserved share program under which the issuer intends to sell securities to Canadian directors, officers or employees.
- The underwriters intend to market to individuals or purchasers that are not "permitted clients".
- Residents of Canada own more than 10% of the outstanding securities of the class being distributed or represent more than 10% of the total number of holders, after giving effect to the offering.
- The issuer is conducting a rights offering.
- The offering is being sold initially without a U.S. registration statement, but a registered exchange offer is contemplated.
- The securities being issued are exchangeable into securities of a different issuer.

Nevertheless, the new wrapper exemption eliminates many of the costly barriers that previously hindered the ability of Canadian institutional investors to access highly desirable foreign securities. We have noticed a considerable decline in the volume of wrappers since the rule amendments came into force, and we expect this trend to continue in the future.

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09
Recent SEC Rulemaking Developments

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Set forth below is an overview of a few recent U.S. Securities and Exchange Commission (SEC) rulemaking developments potentially relevant to Canadian companies that are currently listed or reporting in the U.S., or that are considering an initial public offering (IPO) in the U.S. or listing securities on a U.S. exchange.

Resource Extraction Proposal

In December 2015, the SEC proposed Rule 13q-1 and an amendment to Form SD. The proposed rules would require all reporting issuers under the *Securities Exchange Act of 1934*, as amended (Exchange Act), including Canadian and other foreign companies, that are engaged in the commercial development of oil, natural gas or minerals to report information about payments made to the U.S. federal government or foreign governments that are related to the commercial development of these resources.[1] The stated purpose of the rule (which implemented a provision of the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* [Dodd–Frank Act]) is to increase the transparency of payments made by these companies to governments in order to help combat global corruption and empower citizens of resource-rich countries to hold their governments accountable for the wealth generated by those resources. In many respects, the proposed rules are consistent with corresponding regulations in the European Union (EU) and in Canada, and the SEC has framed its proposal as a further step in supporting international transparency efforts.

Under Rule 13q-1 as re-proposed, a "resource extraction issuer" (meaning an issuer that is required to file with the SEC annual reports on Forms 10-K, 20-F or 40-F under the Exchange Act and engages in the commercial development of oil, natural gas or minerals) would be required to disclose in a Form SD no later than 150 days after the end of such issuer's fiscal year certain payments made to the U.S. federal government or a foreign government for each project.[2]

1 Rules implementing section 13(q) were originally adopted by the SEC in 2012; however, the U.S. District Court for the District of Columbia vacated these rules on the basis of two findings: first, that the SEC misread section 13(q) to compel the public disclosure of issuers' reports; and second, the SEC's explanation for not granting an exemption when disclosure is prohibited by foreign governments was arbitrary and capricious.

2 The SEC did not extend this requirement to issuers that are exempt from Exchange Act registration and reporting under Rule 12g3-2(b), which provides relief to foreign private issuers that are not currently Exchange Act reporting companies (*i.e.*, they are not listed nor have made a registered offering in the United States) and whose primary trading market is located outside the United States. Imposing a resource extraction reporting requirement on such issuers would go beyond what is contemplated by section 13(q), which defines a "resource extraction issuer" as an issuer that is "required to file an annual report with the SEC".

The proposed rules would require resource extraction issuers to disclose, among other things, the type and total amount of non-*de minimis* payments to the U.S. federal government or any foreign government related to the commercial development of oil, natural gas or minerals for each project.[3] Such payments include taxes, royalties, fees (including license fees), production entitlements, bonuses and other material benefits. The SEC added two categories of payments that were not required to be disclosed under the prior rules: dividends (except for dividends paid to a government as a common or ordinary shareholder of the issuer and therefore paid to the government under the same terms as for other shareholders) and payments for infrastructure improvements, such as building a road or railway to further the development of oil, natural gas or minerals.

Under the proposed rules, and consistent with the transparency regulations adopted in the EU and Canada, resource extraction issuers are not required to disclose social or community payments, such as payments to build a hospital or school. As the SEC noted, it is unclear whether these types of payments are part of the commonly recognized revenue stream for the commercial development of oil, natural gas or minerals.

In a change from the 2012 rules, the proposed rules define "project" as operational activities governed by a single contract license, lease, concession or similar legal agreement that forms the basis for payment liabilities to a government. Although similar to the EU directives and the Canadian draft definitions, the SEC's proposed definition would allow issuers additional flexibility to treat multiple agreements that are both operationally and geographically interconnected as a single project without the additional requirement that the agreements also have "substantially similar terms" – as required by the EU and Canadian draft definitions. The SEC opted to define "project" using the same core elements used in the EU directives and the Canadian draft definitions to help reduce compliance costs for issuers that are listed in both the United States and the EU or Canada by not requiring different disaggregation standards for project-related costs. In addition, such an approach might enable issuers to take advantage of equivalency provisions available in other jurisdictions.

The proposed rules do not provide for exemptions for countries that prohibit the mandated resource extraction disclosures; however, the SEC noted that it will consider using its existing authority under the Exchange Act to provide exemptive relief at the request of a resource extraction issuer. This case-by-case approach to exemptive relief, according to the SEC, is preferable to either adopting a blanket exemption for a foreign law prohibition (or for any other reason) or providing no exemptions and no avenue for exemptive relief.

In light of similar disclosure laws adopted by other countries and with a view to reducing compliance costs, the SEC proposed a provision that is consistent

3 The proposed rules define "not *de minimis*" as any payment, whether a single payment or a series of related payments, that equals or exceeds US$100,000 during the same fiscal year.

with the Canadian and EU frameworks. The provision allows issuers to meet the requirements of the proposed rule by providing disclosures that comply with a foreign jurisdiction's rules or that meet the U.S. Extractive Industries Transparency Initiative reporting requirements if the SEC determines that those rules or requirements are substantially similar to the proposed rules.

A final rule has not been released. The SEC proposed an extensive comment process and expects to vote on the proposed rules in June 2016, although the SEC noted that a number of factors may cause it to depart from this expedited schedule.

Proposed Rule 10D-1: Listing Standards to Recover Erroneously Awarded Executive Compensation

On July 1, 2015, the SEC proposed a new rule to implement section 954 of the Dodd-Frank Act. The comment period for proposed Rule 10D-1 of the Exchange Act ended in September 2015; however, to date a final rule has not been released. Under proposed Rule 10D-1, U.S. national securities exchanges must adopt listing rules that will require all listed issuers, including Canadian companies and other foreign private issuers, to adopt, publicly disclose and implement written policies to recover from the issuer's current and former executive officers any incentive-based compensation received that was based on materially erroneous financial information.[4]

The recovery policy would apply to all incentive-based compensation received by executive officers during the three completed fiscal years immediately preceding the date on which the issuer is required to prepare an accounting restatement to correct an error that is material to its previously issued financial statements.[5]

4 Rule 10D-1, as proposed, will apply to all issuers with any securities listed on a U.S. national securities exchange, including issuers with only debt securities listed.

5 The term "executive officer" is defined to include the issuer's president, principal financial officer, principal accounting officer (or if there is no such accounting officer, the controller), any vice-president of the issuer in charge of a principal business unit, division or function (such as sales administration or finance), any other officer who performs a policy-making function, or any other person who performs similar policy-making functions for the issuer. Executive officers of the issuer's parent or subsidiaries are deemed executive officers of the issuer if they perform such policy-making functions for the issuer. The proposed rule would require recovery of excess incentive-based compensation received by an individual who served as an executive officer of the listed issuer at any time during the performance period for that incentive-based compensation. Incentive-based compensation would be subject to the issuer's recovery policy under the proposed rule to the extent that it is received while the issuer has a class of securities listed on an exchange.

The issuer's obligation to prepare the restatement will trigger the application of the recovery policy. Recovery of the excess compensation will be on a pre-tax, no-fault basis and the issuer cannot indemnify or reimburse the affected officers.

"Incentive-based compensation" is defined in the proposed rule as any compensation that is granted, earned or vested wholly or in part upon the attainment of any financial reporting measure. Financial reporting measures are measures that are determined and presented in accordance with the accounting principles used in preparing the issuer's financial statements, any measures derived wholly or in part from such financial information, and stock price and total shareholder return, regardless of whether such measures are included in an SEC filing or the issuer's financial statements. In the case of compensation based on stock price or shareholder return, the issuer must calculate the recovery amount by making a reasonable estimate of the accounting restatement's effect on the applicable measure. The recovery policy would not apply to compensation awarded strictly on the basis of discretionary, subjective, operational or strategic measures that are not financial reporting measures.

EXCEPTIONS

The SEC proposed only two exceptions to the mandatory enforcement of the recovery policy. First, listed issuers can decide not to recover excess incentive-based compensation if recovery is impractical because the direct cost of recovery is greater than the recovery amount.[6] Second, foreign private issuers do not have to enforce their recovery policy if it would violate the laws of their home country.[7] Any listed issuer making use of either exception must provide detailed supporting documentation to its listing exchange.

DISCLOSURE REQUIREMENTS

Rule 10D-1, as proposed, will impose various disclosure obligations on a listed issuer, including the requirement to file its written recovery policy as an exhibit to its Form 10-K (or, in the case of a foreign private issuer, Form 20-F or Form 40-F, as applicable). Each listed issuer will be required to disclose annually how it has applied its recovery policy if at any time during its last completed fiscal year

6 To prevent potential conflicts of interest, any determination that recovery would be impractical would need to be made by the issuer's committee of independent directors that is responsible for executive compensation decisions. In the absence of a compensation committee, the determination would need to be made by a majority of the independent directors serving on the issuer's board of directors. Such a determination, as with all determinations under proposed Rule 10D-1, would be subject to review by the listing exchange.

7 The relevant home country law must have been adopted in the home country prior to the publication in the *Federal Register* of proposed Rule 10D-1. Interestingly, there is no corresponding exception for a recovery that would violate the laws of the executive officer's home country.

either it completed a restatement that required recovery of excess incentive-based compensation under its recovery policy or there was an outstanding balance of excess incentive-based compensation from the application of that policy to a prior restatement. The required disclosure would include the date of the accounting restatement, the recovered amount and the applicable incentive measure. A listed issuer that decides not to recover excess incentive-based compensation because recovery would be impractical must disclose the name of the applicable officer, the amount that would have been recovered and the issuer's reasons for not recovering such amount.

Domestic listed issuers would include the proposed disclosure in their annual reports on Form 10-K and any proxy and consent solicitation materials that require executive compensation disclosure under Item 402 of Regulation S-K. Foreign private issuers, including Canadian issuers using the multijurisdictional disclosure system (MJDS), would be required to provide the same disclosure in, and to file their recovery policies as an exhibit to, the annual reports they file with the SEC on Form 20-F or Form 40-F, as applicable. Because foreign private issuers are exempt from section 14(a) of the Exchange Act, they would not be required to disclose the information in any proxy or consent solicitation materials with respect to their securities.

→ The FAST Act: Improving the Initial Registration Process for Emerging Growth Companies in the United States

The *Fixing America's Surface Transportation Act* (FAST Act), signed into law on December 4, 2015, contains a few legislative amendments that enhance certain benefits introduced under the *Jumpstart Our Business Startups Act* of 2012 (JOBS Act) and will help improve the registration process for emerging growth companies (EGCs) conducting an IPO in the United States.[8] For example, for an EGC that has confidentially submitted its registration statement to the SEC

8 An "emerging growth company" is defined as an issuer that has not completed an IPO of common equity securities prior to December 9, 2011, and that had "total annual gross revenues" of less than US$1 billion during its most recently completed fiscal year. An issuer's EGC status terminates on the earliest of (i) the last day of the first fiscal year of the issuer during which it had total annual gross revenues of US$1 billion or more; (ii) the last day of the fiscal year of the issuer following the fifth anniversary of the date of the issuer's initial public offering; (iii) the date on which the issuer has issued more than US$1 billion in non-convertible debt during the previous three-year period; and (iv) the date on which the issuer is deemed to be a "large accelerated filer" under the *Securities Exchange Act of 1934*, as amended (Exchange Act) (*i.e.*, it has a public float of at least US$700 million and has been a reporting issuer for at least one year).

for review, the FAST Act reduces the period of time that the issuer must wait before it may commence its IPO road show after it publicly files its registration statement with the SEC. And to help reduce IPO costs, the FAST Act contains a long-awaited amendment enabling EGCs to omit from their preliminary registration statements certain financial information, and it mandates the SEC to review and simplify the extensive disclosure requirements in Regulation S-K. However, as discussed below, these legislative amendments will be of interest primarily to Canadian issuers that qualify as EGCs and are considering an IPO in the United States but are not eligible to use the MJDS because they are either private companies or they do not meet the Canadian reporting history or public float requirements.

REDUCED WAITING PERIOD BEFORE THE ROAD SHOW

Under the JOBS Act, an EGC may submit to the SEC a draft registration statement for confidential non-public review prior to a public filing so long as that registration statement and all amendments thereto are publicly filed with the SEC no later than 21 days before the EGC commences its IPO road show. The FAST Act reduces the wait period to 15 days, from 21 days. The confidential non-public review process for EGCs is useful for Canadian companies that qualify as EGCs and intend to file a non-MJDS IPO registration statement with the SEC.[9]

OMITTING CERTAIN FINANCIAL INFORMATION FROM AN INITIAL SEC FILING OR SUBMISSION

The FAST Act allows an EGC that is filing (or confidentially submitting) a Form S-1 or Form F-1 registration statement to omit from the registration statement annual audited financial information that relates to a prior fiscal year if the issuer reasonably believes that the omitted information need not be included in the registration statement at the time of the contemplated offering.[10] To take advantage of this potential cost-saving measure, the issuer must, prior

9 The confidential non-public SEC review process prior to a public filing is not available for an MJDS issuer that files the MJDS Form F-10 registration statement with the SEC even if the issuer qualifies as an EGC. MJDS issuers filing a Form F-10 registration statement with the SEC are required to file publicly with the applicable Canadian securities commission(s) a prospectus that complies with Canadian disclosure requirements. According to SEC staff, the confidential non-public SEC review process for EGCs is not available for an MJDS issuer filing a Form F-10 registration statement with the SEC because the issuer is filing publicly its Canadian prospectus in Canada. However, the confidential non-public SEC review process is not particularly useful for an MJDS issuer filing a Form F-10 registration statement with the SEC because the SEC generally will not review that registration statement (even though the SEC reserves the right to do so) except possibly to confirm that the issuer meets the F-10 eligibility requirements.

10 MJDS issuers filing a Form F-10 registration statement with the SEC must provide financial statements for the years required under applicable Canadian securities laws.

to distributing a preliminary prospectus, amend its registration statement to include all financial information that is required under the rules at the time of amendment. The amendment should help reduce IPO costs for some issuers by eliminating the need to incur audit fees and other incremental costs associated with including audited financial statements for a prior year that will not be included in the IPO prospectus.

For example, an EGC whose fiscal year coincides with the calendar year and is planning an IPO in 2017 after its 2016 annual audited financial statements become available may omit its 2014 annual financial statements from a registration statement that it files with (or confidentially submits to) the SEC before its 2016 annual audited financial statements become available. Prior to distributing a preliminary prospectus in 2017, the issuer will need to file an amended registration statement that includes the required 2015 and 2016 annual audited financial statements. The amendment enables the issuer in this example to avoid incurring incremental costs (that would have otherwise been incurred) to include its 2014 financial statements in the earlier version of the registration statement.

An EGC will not be able to omit from its registration statement interim financial information that will be replaced in a subsequent amended filing at the time of the offering with more recent or updated financial information covering a subsequent interim or annual period. For example, in the case of the calendar year EGC discussed above that is planning an IPO in 2017 after its 2016 annual audited financial statements become available, that issuer may not omit its nine-month 2016 interim financial statements from a prior SEC filing (or confidential submission) because those financial statements include relevant financial information relating to the 2016 fiscal year that will be covered in the issuer's 2016 annual audited financial statements, which must be included in the registration statement at the time of the offering.

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If you are interested in receiving more information, please contact us or visit our website at www.dwpv.com.

The information in this guide should not be relied upon as legal advice. We encourage you to contact us directly with any specific questions.

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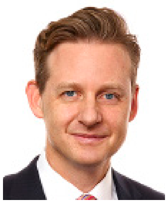

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