DAVIES

2018 Canadian Capital Markets Report

Looking Back, Looking Ahead

Contents

Overview

While global markets remained volatile in 2017, Canadian capital markets saw a resurgence of IPOs and the emergence of new industries such as cannabis and blockchain. Canadian regulators also kept busy in 2017 responding to shareholder complaints and investigating ways to reduce the regulatory burden for reporting issuers.

It is in this context that we are pleased to provide you with an overview of the trends and developments in the Canadian capital markets in 2017 and to share with you our views of their potential impact for 2018.

The $245-million investment by Constellation Brands, a NYSE-listed producer of beer, wine and spirits, in TSX-listed Canopy Growth in the fall of 2017 sparked interest across North America in the Canadian cannabis industry. Since the Constellation Brands investment, capital markets activity in the cannabis space has soared. In the first quarter of 2018 alone, over $1.4 billion of equity was raised by cannabis companies listed on Canadian stock exchanges. We discuss recent developments in the sector in **The Cannabis Frenzy**.

The year 2017 was one of tremendous growth for blockchain, as the technology underlying bitcoin gained attention from mainstream media outlets, financial institutions, investment funds and securities regulators across the globe. Blockchain's rise to prominence was led by an interest in blockchain-based token sales, commonly referred to as initial coin offerings, which raised almost US$4 billion in 2017. We break down the blocks in **Demystifying Crypto in Canada**.

The volume of initial public offerings in Canada rebounded in 2017. After a dismal 2016, a total of 38 initial public offerings in which Canadian companies (or companies listed on Canadian exchanges) raised an aggregate of $5.1 billion in 2017, compared with eight new issues in 2016, raising an aggregate of only $464 million. A few noteworthy trends are discussed in **Initial Public Offerings in Canada: Recent Trends and Developments**.

In November 2017, the Toronto Stock Exchange published a staff notice providing guidance to TSX-listed issuers on their disclosure obligations when applying to the TSX for approval of a private placement. The staff notice did not alter the substantive requirements of the TSX relating to the approval of private placements. Rather, it was a reaction to an Ontario Securities Commission decision to overturn the listing approval granted by the TSX for a private placement by Eco Oro Minerals Corp. without a full understanding of the facts. We discuss the impact of the Eco Oro decision in **TSX Heightens Scrutiny of Private Placements**.

In March 2018, the Canadian Securities Administrators announced six policy projects aimed at reducing regulatory burdens for non-investment fund reporting issuers. These initiatives were selected following a public consultation to determine which areas were of most concern to market participants and most achievable within the scope of securities regulation. Read more in **CSA to Pursue Six Initiatives to Cut "Red Tape" for Reporting Issuers**.

One of the six policy initiatives announced by the Canadian Securities Administrators in 2018 was the facilitating of at-the-market offerings. ATM offerings allow issuers to sell securities under a prospectus over a determined period of time, through the facilities of a stock exchange and at the prevailing market price at the time of sale. ATM offerings are very common in the United States, but have been much less frequent in Canada due to limitations imposed by Canadian securities laws that necessitate exemptive relief in order for an issuer to effect the offering in an efficient manner. Given the recent CSA announcement, we look forward to **A New Framework for At-the-Market Offerings**.

In 2016, the Ontario Securities Commission took a big first step toward fixing Canada's problematic framework for regulating offshore offerings when it first proposed OSC Rule 72-503, *Distributions Outside of Canada*. In December 2017, the OSC took a further step when it published a new and improved version of that rule. The final rule is an effective and practical solution for most common offshore offerings by Ontario-based issuers. However, there remains the glaring issue of its scope – it applies only in Ontario and therefore is not a national solution. We think more can be done. See **Bordering on Modern: Will Ontario's New Offshore Offering Rules Inspire a National Solution?**

In May 2017, the Ontario government announced amendments to the *Securities Act* (Ontario) that would have the effect of requiring some registered dealers to register to be recognized as clearing agencies. This change is an expansion of the scope of the existing rules: registered dealers are not currently subject to the clearing agency regime. After the new rules come into effect, registered dealers will be required either to apply to be recognized as a clearing agency (and comply with the rules applicable to clearing agencies) or to obtain an exemption from doing so if they engage in certain activities. Find out more in **Ontario Clearing Agency Regime to Be Extended to Registered Dealers**.

From a U.S. perspective, 2017 was a fairly quiet rulemaking year. The U.S. Department of the Treasury issued recommendations to promote access to capital through, among other things, reducing regulatory obligations and modernizing the U.S. capital markets regulatory structure and processes. The SEC's proposed and final rules issued in 2017 focused primarily on improving the readability, navigability and accuracy of SEC disclosure documents. While some of these rules are applicable only to U.S. issuers, we discuss how these initiatives impact Canadian issuers that are reporting companies in the United States in **SEC Rulemaking Developments in 2017**.

The Cannabis Frenzy

While the Canadian capital markets were volatile in 2017, market activity in the Canadian cannabis sector achieved unprecedented highs. The $245-million investment by Constellation Brands, a NYSE-listed producer of beer, wine and spirits, in TSX-listed Canopy Growth in the fall of 2017 sparked interest across North America in the Canadian cannabis industry.

Since the Constellation Brands investment, capital markets activity in the cannabis space has soared. In the first quarter of 2018 alone, over $1.4 billion of equity was raised by cannabis companies listed on Canadian stock exchanges.

Against this backdrop, we have summarized below some of the significant developments in the cannabis sector and expected trends for 2018.

The *Cannabis Act* is being reviewed by five Senate committees (Aboriginal Peoples; Legal and Constitutional Affairs; National Security and Defence; Foreign Affairs and International Trade; and Social Affairs, Science and Technology), with the aim of having it receive royal assent by July 2018.

SECOND READING PASSES

After much speculation and debate, the federal *Cannabis Act*, which will legalize access to recreational cannabis and regulate the growing, production and distribution of recreational cannabis in Canada, was passed by a 44-to-29 vote on March 22, 2018, at second reading in the Senate of Canada. This marks an important milestone for the Canadian cannabis industry, as many feared that the Act would get bogged down in the Senate.

Currently, the *Cannabis Act* is being reviewed by five Senate committees (Aboriginal Peoples; Legal and Constitutional Affairs; National Security and Defence; Foreign Affairs and International Trade; and Social Affairs, Science and Technology), with the aim of having it receive royal assent by July 2018.

The *Cannabis Act* assigns significant responsibility for the legal framework of recreational cannabis to the provinces and territories. As a result, the provinces and territories have requested a sufficient period of time between royal assent and enactment of the new law in order to allow for the orderly transfer of cannabis products from federally licensed producers to provincially or territorially authorized distributors and retailers. The Government of Canada has indicated that it will accommodate this request by providing for an 8-to-12-week transition period.

HEALTH CANADA PROPOSES *CANNABIS ACT* REGULATIONS

To support the implementation of the *Cannabis Act*, regulations will need to be enacted. On November 21, 2017, Health Canada published a consultation paper and launched a 60-day public consultation to solicit input on the regulatory approach. Health Canada received 3,218 online and 450 written submissions on the consultation paper. Most of the comments centred on packaging and labelling, security and facilitating access to the industry by "micro-cultivators."

Health Canada does not intend to pre-publish draft regulations for public comment. The final regulations will be published as soon as possible following royal assent to the Act.

THE "SESSIONS EFFECT"

In January 2018, U.S. Attorney General Jeff Sessions rescinded three memos, collectively referred to as the Cole Memorandum, that were adopted in August 2013 under the Obama administration. The Cole Memorandum signalled a shift of government priorities away from strict enforcement of federal laws regulating cannabis and toward a more lenient approach in states that had enacted laws legalizing cannabis and implemented strong and effective regulatory and enforcement systems to control the cultivation, distribution, sale and possession thereof.

Within days of Sessions rescinding the Cole Memorandum, the Canadian Securities Administrators (CSA) issued a notice advising market participants that it was considering whether the existing disclosure-based approach for issuers with U.S. cannabis-related activities, set out in an October 2017 CSA notice, remained appropriate. In February 2018, the CSA provided further guidance on staff's disclosure expectations for issuers with U.S. cannabis-related activities. The February notice reiterated the original guidance provided in October 2017 but included additional disclosure requirements, including the requirement to quantify an issuer's balance sheet and operating statement exposure to U.S. cannabis-related activities and disclosure regarding whether an issuer has obtained legal advice regarding compliance with applicable U.S. state regulatory frameworks.

OPENING OF THE U.S. EQUITY MARKETS

The Sessions Effect did not cool U.S. investors' appetites for cannabis stocks. On February 27, 2018, shares of Cronos Group began trading on Nasdaq, becoming the first Canadian cannabis company to be listed on a U.S. stock exchange. Shortly after listing on Nasdaq, Cronos announced a $100-million cross-border bought deal offering, co-led by GMP Securities and BMO Capital Markets. This was the first cross-border offering by a cannabis company conducted pursuant to the multijurisdictional disclosure system adopted by the United States and Canada and only the second public offering led by a Canadian-bank-owned dealer.

Given the uncertain regulatory environment in the United States and the legal impediments facing U.S. cannabis companies, we expect many U.S. investors to continue to look to Canadian cannabis companies as advantageous investment opportunities. As a result, we anticipate more Canadian cannabis companies listing on U.S. stock exchanges in order to facilitate capital raising efforts in the United States.

BMO ENTERS THE FRAY

Financing of the Canadian cannabis industry has generally been dominated by the independently owned investment banks. This changed in 2018 when BMO Capital Markets co-led bought deal offerings for each of Canopy Growth and Cronos Group. The other Canadian, U.S. and global bank-owned dealers appear to be sitting on the sidelines – for now. We expect to see other Canadian-bank-owned dealers, even those with U.S. operations, jumping into the fray once recreational cannabis is legal.

MIGRATION NORTH?

Given the legal uncertainty in the United States, several cannabis companies with U.S. operations have listed on the Canadian Securities Exchange (CSE). Unlike the TSX or the TSX Venture Exchange, the CSE does not restrict issuers with U.S. cannabis-related activities from trading on the exchange. In March 2018, the shares of Cannex Capital Holdings Inc., a cannabis company based in Washington State that claims to be the biggest in that state, began trading on the CSE. Cannex is one of 63 CSE-listed cannabis companies, including over 14 companies with U.S. operations.

BIG PHARMA WANTS IN

The race is on to secure supply of cannabis products in advance of the enactment of the *Cannabis Act*. Many pharmacies, including Shoppers Drug Mart and Pharmasave, have applied to become licensed sellers of cannabis products and have entered into supply agreements in anticipation of the opening up of the recreational market. Even though most provincial distribution frameworks will be controlled by government-owned subsidiaries, provinces like Alberta and British Columbia have proposed a private retail framework, which could prove to be lucrative to pharmacies with operations in those provinces.

Another growing industry trend is the entry of Big Pharma. Since 2016, CannTrust Holdings Inc. has been partnering with Apotex Inc. to develop new products that will make it easier for patients to use medical cannabis. In March 2018, privately owned Tilray Inc. announced a strategic alliance with Sandoz Canada Inc., a generic drug maker, to develop and sell medical cannabis products carrying both logos.

We expect to see more partnering between national and international Big Pharma and the cannabis industry in 2018, as growing Canadian cannabis companies aim to gain access to the scale, credibility and experience that the pharmaceutical companies have to offer.

NOT OUT OF THE WOODS YET

There remains much skepticism regarding the cannabis sector. In an unhelpful turn of events, three Canadian cannabis companies recently came under attack for questionable conduct by insiders.

In February 2018, Maricann Group Inc., a CSE-listed company, announced in the middle of a public offering that the Ontario Securities Commission was conducting a review of the timing and reporting of trades in securities of the company by certain insiders and that a special committee had been appointed to review the matter. The underwriters backed out of the public offering.

In March 2018, the Ontario and Saskatchewan securities commissions, in reasons released in connection with the hostile takeover bid made by Aurora Cannabis Inc. for CanniMed Therapeutics Inc., criticized certain directors of CanniMed for sharing material non-public information with the hostile bidder. The behaviour did result in private litigation, although this was dropped when Aurora and CanniMed came to terms on a friendly deal.

Also in March 2018, a U.S.-based hedge fund raised concerns about Aphria Inc.'s proposed purchase of Nuuvera Inc. at that time. It was subsequently reported in the media that neither company had disclosed to shareholders voting on the proposed transaction that certain insiders of Aphria held shares in the target company. The disclosure would have been required if the transaction had proceeded by way of a takeover bid, but it was not a mandatory line item in the proxy circular form used for the acquisition. The omission left many questioning whether the disclosure should have been made nonetheless.

BUZZKILL?

In March 2018, a German court stopped the government's tender process for 10 cultivation licences tied to long-term contracts for the supply of 6,600 kilograms of medical marijuana, on the basis that the timeline to respond was too short. A number of Canadian companies were shortlisted for the licences, including Aphria, MedReleaf Corp. and Canopy Growth. Although producers can continue to export medical marijuana to the German market in the meantime, the expected impact of the delay on the selection of the successful bidders resulted in reduced price targets for a number of Canadian cannabis companies.

The Canadian cannabis market was dealt another blow by the *Barron's* cover story on March 30, 2018. *Barron's* issued a strong warning that Canadian pot stocks were overpriced, noting that "today's investors are effectively paying 15 times the industry's cash flow five years from now." The article also raised price-forecast concerns, speculating that the rapid build-out of capacity by the 94 licensed producers in Canada created the potential for a supply glut that will drive down prices and, moreover, that recreational users will not be prepared to pay higher prices for premium brands. This news, coupled with the recent German court decision, leaves us to wonder if the cannabis frenzy will subside in 2018, to be replaced with more measured expectations.

Demystifying Crypto in Canada

The year 2017 was one of tremendous growth for blockchain, as the technology underlying bitcoin gained attention from mainstream media outlets, financial institutions, investment funds and securities regulators across the globe. Blockchain's rise to prominence was led by an interest in blockchain-based token sales, commonly referred to as initial coin offerings (ICOs), which raised almost US$4 billion in 2017 alone.

We previously discussed some of the major legal developments in the blockchain space that occurred in 2017, including the positions taken by Canadian and U.S. regulators on the application of securities laws to blockchain businesses. Since then, the U.S. Securities and Exchange Commission (SEC) has been active in its regulation of the industry. Late last year, the SEC issued a cease-and-desist order against Munchee Inc., a restaurant review mobile application, in respect of its recent ICO. Earlier this year, SEC Chairman Jay Clayton and Commodity Futures Trading Commission Chairman Christopher Giancarlo testified before the U.S. Senate on the proposed regulation of virtual currencies in the United States. According to recent reports, the Ontario Securities Commission (OSC) and the SEC have also launched a broad investigation into many recent ICOs. According to these reports, the OSC has sent out several information request letters and the SEC has issued dozens of subpoenas to those facilitating such offerings.

Given these recent developments and the increased scrutiny of blockchain-based activities, below are key considerations for those active or looking to get active in this space.

The ICO Dilemma: Is the Token a Security?

"SECURITIES TOKENS" VERSUS "UTILITY TOKENS"

The SEC's report on the "DAO" (Decentralized Autonomous Organization) was interpreted by many in the blockchain legal community as an indication that the SEC was concerned with "securities tokens" (which carry an expectation of profit) rather than "utility tokens" (which carry an expectation of use). Signalling a move away from this industry-developed distinction, SEC Chairman Clayton noted in his U.S. Senate testimony that "by and large, the structures of ICOs that I have seen involve the offer and sale of securities" and that "[m]erely calling a token a 'utility' token or structuring it to provide some utility does not prevent the token from being a security." The determination of whether a token is a security will not be isolated to whether or not the token has "utility" but will ultimately depend on the relevant facts and circumstances.

The determination of whether a token is a security will not be isolated to whether or not the token has "utility" but will ultimately depend on the relevant facts and circumstances.

THE EVOLUTION OF A TOKEN

Securities regulators have acknowledged the possibility of a "securities token" changing its characteristics such that it will no longer be considered a security. Although specific guidance has not yet been provided by Canadian regulators on when a token will no longer be considered a security, the practical utility of the token and reliance on the efforts of others for profit will be key considerations in making this determination.

CAPITAL RAISING MAY TAINT THE OFFERING

There are a number of legitimate purposes for conducting an ICO other than raising capital. For example, some blockchain entities use an ICO to distribute tokens to parties interested in using the platform, effectively creating a user base and kick-starting the network. ICO issuers that do not wish to be subject to the restrictions imposed by securities laws should be thoughtful in their approach and expect heavy scrutiny from regulators on any ICO used to raise capital for an issuer's business.

AIRDROPS AND FREE TOKEN ISSUANCES

Recently, token "airdrops," or distributions of free tokens, have increased in popularity. Where an issuer wishes to avoid any form of capital raising that may potentially trigger a review by securities regulators but still wishes to disseminate its token, an airdrop could be used in lieu of an ICO. In theory, airdrops can be limited to persons that have provided evidence of their intended use of the platform, thereby ensuring only active users receive tokens. While Canadian regulators have not addressed airdrops, an argument could be made that an "investment of money" has not occurred in an airdrop scenario, and that the first prong of the test for investment contracts set out in *SEC v. W.J. Howey Co.* fails on this basis.

AVOID CREATING AN "EXPECTATION OF PROFIT"

If a token issuer primes investors to expect an appreciation in the value of the tokens or promises dividends or other income streams, the tokens will likely be considered securities. Even where issued tokens have utility, a secondary expectation of profit may render a token a security. For example, in the recent Munchee order referred to above, the SEC stated that "[e]ven if MUN tokens had a practical use at the time of the offering it would not preclude the token from being a security."

MARKETING ACTIVITIES

When marketing an ICO, whether through formal documentation such as a white paper or through informal channels such as blog posts, podcasts or YouTube videos, issuers should avoid discussing any profits to be gained by acquiring a token, as this will likely be seen as priming investors' expectations for future profits.

EXCHANGE LISTINGS AND SECONDARY MARKET TRADING

Any action taken by a token issuer's development team to list tokens on an exchange or otherwise facilitate secondary market trading may be seen as creating an expectation of profit. However, in a truly decentralized platform, there are limited methods available to prevent other members of a token ecosystem from setting up an exchange listing independent of the development team. In addition, certain decentralized exchanges allow for the trading of Ethereum-based "ERC20" tokens, notwithstanding that the token issuer hasn't consented to or otherwise been involved in such listing in any way.

> Although specific guidance has not yet been provided by Canadian regulators on when a token will no longer be considered a security, the practical utility of the token and reliance on the efforts of others for profit will be key considerations in making this determination.

TARGETING BROADER MARKETS

Issuers should limit marketing and sales activities to current or potential users of the tokens. Where the issuer's business focuses on a niche industry or geographic market, its ICO should not target cryptocurrency investors or investors overseas who cannot use tokens for their intended purpose. The SEC criticized Munchee, a restaurant review application only available in the United States, for targeting crypto investors by advertising on cryptocurrency message boards and translating the offering documents into various languages, since it indicated the tokens were being sold for profit rather than for use.

LIMIT SPECULATIVE INVESTMENT

Issuers should take concrete measures to limit participation in an ICO based on pure speculation that the token price will increase. Imposing an investment cap of a low amount with no investment floor may help to ensure tokens are widely distributed and deter speculation due to the limited upside of such a small investment. Elements of consumptive tokens (i.e., tokens that are extinguished or surrendered upon use or after a certain period) also serve to reduce speculation. For example, some platforms have instituted a "use it or lose it" approach, whereby tokens are extinguished if not used by a certain date. "Tethering" or tracking the value of a token to a physical asset may similarly deter speculative investment.

DETERMINING THE "EFFORTS OF OTHERS": HOW MUCH EFFORT IS ENOUGH?

Reliance on the efforts of others – the fourth prong of the *Howey* test – will be satisfied where the founders or management have control over the business or platform. This may include developing a mobile application, creating an ecosystem for the platform or negotiating contracts with commercial parties. However, it is unclear whether this prong will be satisfied where the management team performs purely administrative functions, such as managing or updating a mobile application.

TOKENS IN DEVELOPMENT

Tokens issued in respect of platforms that are not fully developed (and hence do not have any immediate use) will not be considered utility tokens and should properly be considered securities due to the reliance on the efforts of others. This point was emphasized by SEC Chairman Clayton in his testimony to the U.S. Senate, where he contrasted tokens being issued in respect of a "participation interest in a book-of-the-month club" to an offering analogous to an interest in a "yet-to-be-built publishing house with the authors, books and distribution networks all yet to come."

ACCURATE AND HONEST DISCLOSURE

Securities regulators have been quick to shut down ICOs where the issuer discloses false or inaccurate information in its white paper or other offering materials, including in respect of the credentials of team members or relationships with advisers. For example, the SEC recently halted AriseBank's ICO due to numerous alleged misrepresentations made by the company, including for the failure to "disclose the criminal background of key executives." The SEC is also carefully looking at public companies that have recently shifted their business models to focus on blockchain and cryptocurrencies, and recently suspended three companies for misleading disclosure in respect of their blockchain-related activities.

LIMITING SALES TO INVESTORS OUTSIDE THE UNITED STATES AND CANADA

Some blockchain enterprises have limited the issuance of tokens to investors outside the United States or Canada on the basis that securities laws of those jurisdictions would not apply to such investors. Issuers that pursue this route should be mindful of jurisdiction-specific rules or policies such as the risk of "flowback" or other connecting factors to the jurisdiction that result in the application of local law to foreign distributions. On March 31, 2018, Ontario adopted a "safe harbour" for distributions of securities (including securities tokens) outside Canada where the issuer of the token materially complied with the disclosure requirements under the securities laws of the non-Canadian jurisdiction in which the tokens were distributed or the distribution was exempt from any such requirements. However, tokens issued under this safe harbour are subject to a "restricted period" under Ontario securities laws, which means that the unrestricted transfer of such tokens to persons in Canada will require the issuer to be a reporting issuer in Canada. Issuers intending to rely on this exemption may instead wish to consider taking measures to ensure that the tokens "come to rest" outside Canada.

The SEC is carefully looking at public companies that have recently shifted their business models to focus on blockchain and cryptocurrencies, and recently suspended three companies for misleading disclosure in respect of their blockchain-related activities.

CRYPTO COLLECTIBLES ARE LIKELY NOT SECURITIES

In a statement confirming that not all tokens issued in an ICO are securities, the British Columbia Securities Commission stated that tokens underlying crypto collectibles (e.g., CryptoKitties, a blockchain-based game in which players collect virtual cats, similar to a modern day Tamagotchi) are not subject to securities laws. This is likely due to the fact that no expectation of profit has been formed as a result of the issuance of these crypto collectibles.

Simple Agreements for Future Tokens (SAFTs): A Way Forward?

SAFTS ARE TYPICALLY SECURITIES

A SAFT is a written instrument entered into prior to release of a blockchain platform that effectively provides its holder with the right to fully functional tokens, delivered once the platform is completed. Designed to be sold to accredited investors as a means of raising capital, a SAFT (which is more clearly a security) must comply with applicable securities laws. SAFTs will also typically set out the rights of holders on insolvency or the failure of the issuer to complete a functional platform. Once the platform is released and the tokens gain sufficient utility, proponents of the SAFT model argue, the underlying tokens issued upon conversion of a SAFT are not securities and should be freely transferable outside the ambit of securities laws.

TOKENS ISSUED ON CONVERSION OF A SAFT MAY STILL BE SECURITIES

Whether the underlying tokens issued upon conversion of the SAFT are securities will depend on the facts and circumstances of each case. For example, if token holders are reliant on the efforts of the management team to finalize development of the blockchain platform following the conversion of a SAFT, securities regulators may still consider the underlying tokens to be securities, notwithstanding their practical use and the fact that the bulk of work to develop the platform has been completed by the time the tokens are issued.

OFFERING DISCOUNTS ON SAFTS

A common issue arises when discounts are offered on tokens, since it is an acknowledgment that the tokens are being acquired for speculative purposes. Offering discounts on SAFTs, but not on the tokens upon conversion, may help alleviate this issue (i.e., it acknowledges that the SAFTs, which are securities, are speculative but the tokens themselves are not). Alternatively, offering a discount when the token is used rather than when it is distributed (i.e., as part of the SAFT offering or ICO) would motivate holders to use the token for its intended purpose, thereby increasing utility.

SAFTS AND HOLD PERIODS

In some cases, a SAFT holder will be subject to a lockup, pursuant to which such holder will be unable to convert its SAFT for a specified period. Hold periods have been used to prevent significant holders from dumping the tokens at a profit as soon as the platform is released and the tokens are freely tradable. However, securities regulators may view holding periods as an acknowledgment that the issued tokens are a speculative investment and therefore securities, since the lockup is often instituted to prevent price manipulation. As well, a hold period effectively prevents the holder from using the token for a specified period, undermining its status as a utility token. While not recommended, token issuers that wish to implement a hold period on a SAFT should start the clock upon the issuance of the SAFT itself and not on the date the tokens are issued, to avoid indirectly acknowledging the token has security-like features.

Process and Timing: Conquering Logistics

GO PUBLIC

Enterprises with sufficiently broad-based appeal may consider accessing the public capital markets to raise funds and elevate investor interest. Issuers in the crypto space have successfully achieved public listings through reverse takeovers (RTOs). RTOs involve acquiring a publicly listed shell company and may offer advantages over the traditional initial public offering (IPO) process, such as reduced exposure to transient market volatility. Promoters should anticipate the possibility of enhanced regulatory scrutiny and proactively manage their processes and disclosures accordingly.

SOLICITING INVESTORS ONLINE

Many token offerings are accessed by way of websites and online portals that process prospective purchasers automatically. For securities tokens, use of an online interface may trigger securities law restrictions on operating a marketplace and engaging in the business of trading. Issuers will need to design their websites or sales portals with these rules in mind.

MITIGATING RISK WHILE AVOIDING DELAY

Canadian regulators have indicated they are available for a dialogue to help innovators navigate evolving regulation. Engaging with regulators offers increased certainty and can substantially reduce execution risk. But bringing regulators up to speed takes time, and dialogue can introduce delays. In addition to considering regulatory issues early on, blockchain enterprises should make realistic judgments on timing to facilitate a smooth and efficient route to market.

Investment Funds and Exchanges

CRYPTO FUNDS FACE INCREASED SCRUTINY

Recognizing that funds established solely to invest in one or more cryptocurrencies are a novel business model, Canadian securities regulators have mandated increased reporting requirements and conditions for the registration of such investment funds. While several Canadian cryptocurrency investment funds have been granted an investment fund registration, none have been authorized to go beyond trading in established cryptocurrencies such as bitcoin and ether. Prior approval of the applicable regulator must be sought before a fund may invest in any alternative currencies or “altcoins,” likely due, in part, to custodial and valuation concerns. Investment funds that wish to deal in altcoins may be subject to further requirements, depending on whether these assets are considered securities. Regulators are also entertaining whether additional qualifications (such as computer science training) should be required for funds investing in crypto assets.

CUSTODIAL CHALLENGES

Due to the "bearer-form"-like nature of many cryptocurrencies, holders of this new asset class are familiar with balancing competing needs for secure storage and expedient access. Securities laws impose heightened custodial standards on investment funds' asset storage. Promoters of crypto investment funds should anticipate a dialogue with regulators prior to launch, especially those contemplating altcoin holdings, where sourcing adequate service providers may prove challenging.

VALUATION AND VOLATILITY

Prospective fund operators should anticipate establishing a robust valuation methodology for the crypto assets they intend to hold. Regulators are likely to consider the volatility and valuation sources of underlying assets in assessing whether the fund itself can satisfy its valuation and reporting obligations to investors.

FACILITATING AND FILTERING TRANSFERS

The ability to transfer and dispose of tokens, whether by trading, spending or "burning," is ubiquitous among crypto asset platforms. Sophisticated platforms may help connect holders to facilitate token transfers, or may filter prospective buyers. For securities tokens, facilitating and filtering may trigger rules applicable to securities exchanges, other marketplaces or investment dealers. Parties interested in setting up these platforms should engage legal advisers early in the process to design around hurdles, line up required licences or initiate a dialogue with regulators.

Promoters of crypto investment funds should anticipate a dialogue with regulators prior to launch, especially those contemplating altcoin holdings, where sourcing adequate service providers may prove challenging.

CHAPTER 03

Initial Public Offerings in Canada: Recent Trends and Developments

The volume of initial public offerings (IPOs) in Canada rebounded in 2017 after a dismal 2016, with a total of 38 IPOs in which Canadian companies (or companies listed on Canadian exchanges) raised an aggregate of $5.1 billion, compared with eight new issues in 2016, which raised an aggregate of only $464 million.

A significant number of the issuers carrying out IPOs in 2017 offered subordinate voting shares to investors, with the founders or controlling shareholders retaining control of the issuer through multiple voting shares carrying between 10 and 50 votes per share.

A few trends and developments were noteworthy from our standpoint, including issuers' continued use of multiple voting shares and the use of growth outlooks to bolster valuations and ensure the successful completion the offering.

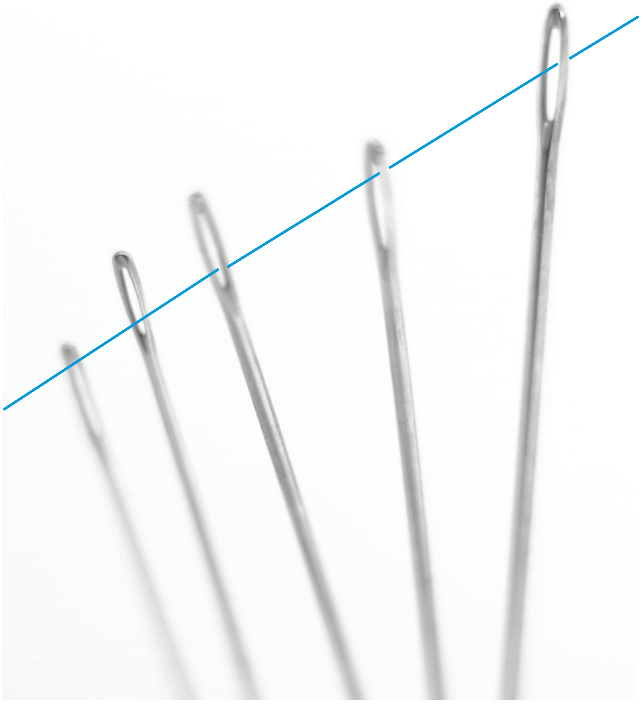
The year 2017 also witnessed an increasing use of reverse takeovers as a means to list shares on the Toronto Stock Exchange (or TSX Venture Exchange), with some issuers perceiving reverse takeovers as easier and cheaper than the traditional IPO. And finally, in 2018, Spotify Technology N.A. began trading on the New York Stock Exchange after completing a direct listing offering, or DLO, an alternative approach to going public that is infrequently used in Canada and the United States.

DUAL-CLASS SHARE STRUCTURES

A significant number of the issuers carrying out IPOs in 2017, including some of the highest-profile names, offered subordinate voting shares to investors, with the founders or controlling shareholders (including often the private equity sponsors of the issuer) retaining control of the issuer through multiple voting shares carrying between 10 and 50 votes per share.

To mitigate the misalignment between economic and voting rights of subordinate shareholders, the Toronto Stock Exchange requires the use of coattails, either as a bylaw of the issuer or a coattail agreement, which protect holders of subordinate voting shares in a change of control. In addition, securities regulators require a heightened level of disclosure by issuers with subordinate voting shares. Despite the relative unpopularity of dual-class share structures with institutional investors and among certain practitioners and academics, and the aforementioned regulatory constraints, issuers keep returning to this structure for various reasons, including the stability that such a structure can inject to a business, shielding it from the pressures of short-term holders and activists.

Interestingly, despite their misgivings regarding the structure, some institutional investors elect to participate in IPOs, like retail investors. Indeed, investors such as the Caisse de dépôt et placement du Québec (Caisse), British Columbia Investment Management Corporation (BCI), Ontario Teachers' Pension Plan (Teachers'), Ontario Municipal Employees Retirement System (OMERS), Canada Pension Plan Investment Board (CPPIB) and Blackrock Canada all have published policies with respect to dual-class share structures. Some institutional investors such as CPPIB, BCI, OMERS and Blackrock Canada will



openly oppose new dual-class share structures. Others, such as Caisse, do not have an outright prohibition on purchasing subordinate voting shares, but will seek to ensure that the structure allows for fair and equitable treatment of both classes of shareholders, to be assessed on a case-by-case basis. According to the Canadian Coalition for Good Governance (CCGG), the best practice for companies undertaking IPOs is to utilize a single class of voting common shares – using dual-class share structures only in exceptional circumstances. As a result, the CCGG has set out principles for companies in those exceptional circumstances, including with respect to the maximum number of directors to be elected by the multiple voting shareholders (e.g., two-thirds) and the collapse of the structure. In addition, according to Caisse and the CCGG, multiple voting shares should normally be restricted to six and four votes per share, respectively.

Dual-class share structures made a stunning comeback in 2015 with IPOs undertaken by issuers such as Cara Operations, Shopify and Stingray Digital. Even if by comparison, dual-class share structure IPOs did not strike the imagination in 2017 as much as they did in 2015, multiple voting shares were not a single-year trend and seem to be part of the Canadian landscape for the foreseeable future.

GROWTH OUTLOOK

Forward-looking growth outlooks were also a notable feature of a significant number of IPOs in 2017. Issuers provided outlooks for many financial metrics such as revenue and EBITDA, as well as tangible objectives like store openings and same-store sales.

Canadian securities laws require certain disclosure regarding forward-looking information, including (i) reasonable cautionary language identifying the forward-looking information as such, (ii) reasonable cautionary language identifying material factors that could cause actual results to differ materially from the forecast, and (iii) a statement of the material factors or assumptions that were applied in making the growth outlook. In addition, the cautionary language and disclosure of risk factors and assumptions must appear proximate to the forward-looking information, and the issuer must have had a reasonable basis for making the outlook. An issuer must review the assumptions underlying forward-looking growth outlook and the process followed in preparing such outlook to ensure that a reasonable basis for the statements exists.

Despite a more vital IPO market in 2017, reverse takeovers have continued to be an effective alternative to going public, predominantly in industries such as blockchain and cannabis.

Providing an outlook can be challenging for issuers, their directors, officers and underwriters, from both a diligence and a liability perspective. However, with a proper description of the assumptions relied on in developing the outlook and a reasonable basis for the expected growth, an outlook will often help an issuer achieve the expected pricing for its IPO.

REVERSE TAKEOVERS AND DLOS

Reverse takeovers (also called reverse mergers or back-door listings) have played a substantial role in widening access to Canadian capital markets in the last 20 years as an alternative to the traditional IPO. This is usually the case in the context of a slow IPO market because reverse takeovers do not necessarily require a concurrent financing of the company, therefore offsetting or minimizing any market risk related to the listing process. Despite a more vital IPO market in 2017, reverse takeovers have continued to be an effective alternative to going public, predominantly in industries such as blockchain and cannabis. In addition, whereas traditional IPOs may sometimes seem onerous and time-consuming, reverse takeovers are often seen as a cheaper and more expedient way to go public.

While reverse takeovers have been the subject of negative press in recent years, mostly in the midst of the Sino-Forest Corp. alleged fraud (Sino-Forest originated from a reverse takeover in 1994 – long before it became more popular in the late 1990s and early 2000s), they remain part of the Canadian capital market landscape.

Although the cost and time efficiency of a reverse takeover compared to a marketed IPO process may be debatable, one of the main advantages of a reverse takeover is that it generally does not involve regulatory review, other than by the stock exchange. However, it involves less (or sometimes no) market validation of the business of the target.

Recent successful reverse takeovers include Element Fleet Management (formerly Element Financial Corp), Concordia International (formerly Concordia Healthcare), Aurora Cannabis and Canopy Growth. In 2017, companies such as Hive Blockchain Technologies and Goodfood Market became public through reverse takeovers.

Since rumours of the Spotify DLO began to circulate in the United States, many market participants have questioned whether direct listings will be the new trend in Canada. Although Spotify was able to complete a direct listing on the New York Stock Exchange, effecting a DLO on a Canadian stock exchange can be challenging as a result of the various stock exchange listing requirements, including the requirement to have a certain number of public shareholders. While there are several benefits to a direct listing, not all issuers will be in a position to benefit from such an approach. For example, Spotify was not looking to raise capital and presumably was of the view that a traditional road show was not required to tell its story to investors. Not many Canadian issuers will find themselves similarly situated. The Montréal Exchange proceeded with a direct listing in 2007 on the Toronto Stock Exchange and became a reporting issuer by filing a non-offering prospectus with the securities regulatory authorities in Canada. However, its trading history was short-lived and a year later it combined with the TSX to become TMX Group. In 2011, Postmedia Network Canada Corp. also became a reporting issuer by filing a non-offering prospectus with the Canadian securities regulatory authorities and listing on the TSX. Postmedia was able to satisfy the TSX public float listing requirements because it had issued shares to its creditors under a plan of arrangement and compromise under the *Companies' Creditors Arrangement Act* (Canada).

CHAPTER 04

TSX Heightens Scrutiny of Private Placements

In November 2017, the Toronto Stock Exchange (TSX) published Staff Notice 2017-010 (Staff Notice), which provides guidance to TSX-listed issuers on their disclosure obligations when applying to the TSX for approval of a private placement. The Staff Notice reinforces the TSX's expectation that submissions by listed issuers for a proposed private placement disclose any pending mergers, acquisitions, takeover bids, changes to capital structure or other significant transactions, and details regarding any dissident shareholders and/or anticipated proxy contests involving the issuer.

THE GENESIS OF THE TSX STAFF NOTICE

The Staff Notice has not altered the substantive requirements of the TSX relating to the approval of private placements. Rather, it is a reaction to an Ontario Securities Commission (OSC) decision to overturn the listing approval granted by the TSX for a private placement by Eco Oro Minerals Corp. (Eco Oro) without a full understanding of the facts.

The Eco Oro private placement was scheduled to close eight days before the record date for a shareholders' meeting at which dissident shareholders of Eco Oro were seeking to replace the company's board of directors. The private placement was effected through a conversion of a portion of Eco Oro's outstanding convertible debt securities, at the request and election of Eco Oro and not at the behest of the holders of such securities. Importantly, the holders who had their securities converted into common shares in advance of the Eco Oro shareholder meeting collectively held 41% of Eco Oro's outstanding shares before the private placement (46% post-private placement) and signed support letters agreeing to vote their shares in favour of the incumbent board of directors at the upcoming shareholders' meeting. The OSC found that the TSX either did not know, or did not appropriately absorb, that Eco Oro was facing a contested shareholders' meeting.

In approving the Eco Oro private placement, the TSX concluded, based on representations by the issuer and its counsel, that the transaction would not materially affect control of Eco Oro (which otherwise would have necessitated shareholder approval for the transaction). When Eco Oro issued a press release announcing the closing of the private placement, the dissident shareholders immediately applied to the OSC for a review of the TSX approval.

Applying the TSX's own test for transactions that materially affect control, the OSC found in its decision setting aside the TSX approval of the private placement that it did materially affect control of Eco Oro in the context of the proxy contest and thus required the approval of Eco Oro's shareholders. The OSC cease-traded the shares issued in the private placement and ordered that such issuance be unwound unless shareholder approval of the issuance was obtained. The OSC also ordered that the Eco Oro shares issued in the private placement could not be voted at the contested shareholder meeting.

Applying the TSX's own test for transactions that materially affect control, the OSC found in its decision setting aside the TSX approval of the private placement that it did materially affect control of Eco Oro in the context of the proxy contest and thus required the approval of Eco Oro's shareholders.

In rendering its decision, the OSC made it clear that it did not believe that there was a legitimate business reason for the private placement effected by Eco Oro because it raised no funds as a result of the conversion and certain of the convertible debt securities remained outstanding, meaning that the covenant burden on Eco Oro was not reduced. The OSC found that the sole plausible justification for the private placement was the entrenchment of the incumbent board and management of Eco Oro.

THE *ECO ORO* FALLOUT

The OSC decision in *Eco Oro* gave rise to much commentary and speculation in the marketplace, including with respect to the likely impact of the decision on deal certainty. Much of the speculation has centred on whether the TSX will more closely scrutinize private placements, thereby contributing to longer timelines to complete transactions. Others have questioned whether there is a more efficient and less costly way to address concerns raised by shareholders in the face of a proposed private placement requiring TSX approval.

Since the OSC issued its decision in *Eco Oro*, at least one activist shareholder has appealed the TSX's approval of a private placement to the OSC.

In June 2017, Land and Buildings (L&B) sent an open letter to the board of Hudson's Bay Company (HBC), raising its concerns with management's lack of focus on increasing shareholder value and recommending that the board unlock substantial value in the company's real estate portfolio. Shortly thereafter, L&B sent a second open letter to the board expressing its frustration with the lack of progress made by the company. In the fall of 2017, L&B issued two press releases, the first stating that all options were on the table if HBC did not take action, and the second stating L&B's intentions to requisition a special meeting of shareholders to remove HBC's directors.

On October 24, 2017, HBC announced a series of strategic transactions with WeWork Companies and Rhône Capital, comprising an equity investment by Rhône of US$500 million (C$632 million) in the form of eight-year mandatory convertible voting preferred shares (Preferred Shares) and the sale of the Lord & Taylor Fifth Avenue building to WeWork in a transaction valued at US$850 million (C$1.075 billion).

The equity investment by Rhône required shareholder approval under the TSX rules because (i) it materially affected control of HBC; and (ii) the Preferred Shares included a price protection provision that had the effect of reducing the conversion price of the Preferred Shares if, within the first year following closing, HBC issued common shares at a price lower than the conversion price. In its press release announcing the strategic transactions, HBC advised that it had received written approval of the equity investment from shareholders holding more than 50% of the outstanding HBC common shares.

On November 7, 2017, two weeks after HBC announced the strategic transactions, the TSX granted its conditional listing approval for the issuance of the Preferred Shares to Rhône. On November 15, 2017, L&B appealed the TSX approval of the private placement to the OSC.

In its filings with the OSC, L&B argued that in granting its approval of the equity investment, the TSX did not ask for or review pertinent documentation, such as board materials, financial adviser opinions and correspondence between management, the board and the consenting shareholders. In other words, the TSX had not reviewed sufficient information to make an informed decision, an argument that was successfully used by the dissidents in *Eco Oro*.

After much delay, the OSC hearing was set for December 7 and 8, 2017. On December 1, 2017, HBC announced that it had entered into a settlement agreement with L&B pursuant to which it had agreed that, should it decide to issue common shares at a price below the conversion price of the Preferred Shares during the first year after issuance, it would do so by way of a rights offering to all shareholders. In the settlement agreement, L&B agreed to a standstill effective until the 2018 annual and general meeting of HBC shareholders.

WHERE DO WE GO FROM HERE?

To a certain extent, it is unfortunate that the HBC matter did not proceed to an OSC hearing. Market participants could have benefited from an OSC decision clarifying the lengths to which the TSX must go when approving a potentially contested private placement without requiring shareholder approval for the transaction. L&B's submissions suggested that the TSX should have reviewed volumes of documents in order to make an informed decision. It is not reasonable for market participants to expect this level of review from the stock exchange; nor is it reasonable to expect that issuers should provide such extensive disclosure to the TSX. This continued pressure from activist shareholders could push the TSX down a path of requiring shareholder approval in potentially unwarranted circumstances, causing unnecessary delay and expense.

Market participants will continue to closely monitor the TSX procedures for approval of private placements and developments in circumstances where the TSX imposes conditions, such as shareholder approval, in the face of activist shareholder campaigns. Issuers facing proxy contests or dissident campaigns should anticipate heightened scrutiny from the TSX and longer approval timelines for applications to have private placements approved.

Market participants could have benefited from an OSC decision clarifying the lengths to which the TSX must go when approving a potentially contested private placement without requiring shareholder approval for the transaction.

CHAPTER 05

CSA to Pursue Six Initiatives to Cut “Red Tape” for Reporting Issuers

Consistent with the consultation paper, the CSA intends to consider alternative models in which disclosure in an offering document is more concise and focused than under the existing short form prospectus regime.

The Canadian Securities Administrators (CSA) will be initiating six policy projects aimed at reducing regulatory burdens for non-investment fund reporting issuers. The projects include:

- reviewing potential alternative prospectus models;
- facilitating at-the-market (ATM) offerings;
- revisiting the "primary business" requirement for financial statements to be included in a prospectus;
- removing or modifying the criteria to file a business acquisition report (BAR);
- revisiting certain continuous disclosure requirements; and
- enhancing electronic delivery of documents.

Of the options considered by the CSA, these policy projects were generally supported by stakeholders, are most achievable within the scope of securities regulation and are viewed as having the potential to provide the most impact for reducing regulatory burden. The CSA will be initiating these policy projects in the near term and establishing a mandate, scope and timeline for each.

Background

On March 27, 2018, the CSA released CSA Staff Notice 51-353, *Update on CSA Consultation Paper 51-404 Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers*. In the notice, the CSA provides an update on the progress of its consultation outlined in Consultation Paper 51-404. Our prior publication describing the consultation paper can be found at www.dwpv.com/Consultation-Paper-51-404.

During the consultation paper comment period, the CSA received 57 comment letters and conducted consultations to seek direct feedback from a variety of stakeholders. Based on the comments and feedback from stakeholders, and after considering the criteria noted above, the CSA will be initiating the following six policy projects.

Prospectus Requirements

POTENTIAL ALTERNATIVE PROSPECTUS MODELS

Consistent with the consultation paper, the CSA intends to consider alternative models in which disclosure in an offering document is more concise and focused than under the existing short form prospectus regime.

We believe that conditions are right to adopt such a model, recognizing advancements in the quality of Canadian continuous disclosure stemming from regulatory initiatives adopted since the early 2000s. However, in our view, a public offering in Canada should always be conducted by way of an offering document that (when read together with its incorporated documents) meets the minimum prospectus disclosure standards established by Canadian securities legislation for the protection of Canadian investors. We are also supportive of streamlining the public offering process and review procedures in Canada in conjunction with the adoption of any alternative model.

FACILITATING ATM OFFERINGS

One hurdle facing issuers considering ATM offerings under Canadian securities legislation is that exemptive relief is often required to effect such offerings. We support codifying in securities legislation the exemptive relief typically granted for Canadian ATM offerings.

As part of this policy project, the CSA should also consider additional relief that might be afforded to issuers in order to better align a Canadian ATM offering with the requirements and conditions applicable to a concurrent U.S. offering. Recently, TransCanada Corporation and Fortis Inc. each obtained exemptive relief from the CSA that reduced certain aspects of the administrative burden imposed on Canadian issuers in connection with ATM offerings. We would expect the CSA to give careful consideration to these decisions in modifying the ATM offering regime.

REVISITING THE PRIMARY BUSINESS REQUIREMENTS

Although not specifically identified by the CSA in its consultation paper as an initiative – based on input from stakeholders – the CSA intends to revisit the requirement to include certain historical financial statements in an IPO prospectus for each entity considered the "primary business" of the issuer. The CSA received feedback from stakeholders that considerable time and resources are consumed when creating these statements (if none have been prepared) and that this may delay or prevent the issuer from completing an IPO. Adding to the regulatory uncertainty is the inconsistent approach the CSA has taken in granting exemptive relief from these requirements. We are supportive of the CSA revisiting the necessity of complying with this requirement in all cases and codifying the exemptive relief granted in this regard to date.

Continuous Disclosure Requirements

REMOVING OR MODIFYING THE CRITERIA TO FILE A BAR

Complying with the requirements to file a BAR can be time-consuming, expensive and challenging, in particular where underlying information is difficult to obtain. The CSA frequently receives requests for, and grants, relief related to the BAR requirements. In light of this, we expect that the CSA will consider narrowing the BAR requirements, at a minimum, to conform to the exemptive relief that has already been granted.

REVISITING CERTAIN CONTINUOUS DISCLOSURE REQUIREMENTS

The CSA will review certain continuous disclosure requirements with the dual objectives of reducing the disclosure burden on issuers and enhancing the utility and ease of understanding of disclosure for investors.

We support eliminating duplicative disclosure generally and, in particular, the disclosure currently required in an issuer's financial statements, management's discussion and analysis (MD&A) and certain other disclosure documents. Generally, we also see the benefit of consolidating an issuer's annual MD&A, annual information form and financials into a single annual report and consolidating interim reporting (MD&A and financials) into a single report for each quarter. A single report has the benefit of providing all the necessary disclosure in one place. While we are supportive of this consolidation, we do not believe it should be mandatory. Issuers often choose to file their annual information form on a later date than their financial statements and MD&A, as this affords them additional time to prepare and vet the associated disclosures and provide the annual CEO and CFO certifications.

Other Securities Regulation Requirements

ENHANCING ELECTRONIC DELIVERY OF DOCUMENTS

The CSA received feedback from stakeholders suggesting that electronic delivery be the default delivery method and that paper documents be available as an option to investors. In addition to updating and implementing changes to securities legislation to allow for more practical ways to achieve electronic delivery, we believe the CSA should consider the circumstances in which access to a filed prospectus (and any incorporated documents) on SEDAR should be sufficient to be deemed to constitute delivery of the prospectus for purposes of prospectus delivery obligations under applicable securities legislation without actual delivery of the prospectus (in printed or electronic form). This can be achieved through an "access-equals-delivery" or "notice-and-access" model. We expect the CSA to consider both of these models in the context of delivery of all documents to investors.

What Was Left Behind?

The consultation paper discussed five broad topics and included 33 questions for stakeholders to consider and provide a response. Given the breadth of the consultation, it is no surprise that many of the initiatives are not current priorities for the CSA.

Of note, the CSA will not (at this time) be pursuing a policy project in respect of the following initiatives:

REDUCING THE AUDITED FINANCIAL STATEMENT REQUIREMENTS FOR AN IPO PROSPECTUS FROM THREE TO TWO YEARS

Several stakeholders supported this initiative on the basis that the third year of financial results is not material to investors and that the change would more closely align the CSA's rules with the U.S. requirements for emerging growth companies. Notwithstanding this feedback, the CSA is not pursuing this initiative at this time.

AMENDING THE PRE-MARKETING/ MARKETING REGIME

We and other commenters on the consultation paper noted that the rules surrounding the pre-marketing/ marketing regime are overly strict. In our view, many of these rules are difficult for issuers and their advisers to adhere to. We made several recommendations to the CSA to further liberalize these rules, including expanding the content of a standard term sheet, expanding and clarifying the exceptions for U.S. cross-border offerings, and modifying the requirement that all information in a standard term sheet or marketing materials be disclosed in or derived from information in the applicable prospectus. We continue to be of the view that the pre-marketing/marketing regime can benefit from further amendments and clarifications and that the CSA should consider initiating a policy project to further review this regime.

CHAPTER 06

A New Framework for At-the-Market Offerings

An at-the-market (ATM) offering is an offering of securities, typically common shares, conducted by agents acting on behalf of a reporting issuer using the facilities of a securities exchange or marketplace over a period of time determined by the issuer. The securities sold in the ATM offering are sold at the prevailing market price at the time of sale. Perhaps the most attractive feature of ATM offerings for reporting issuers is that such distributions are significantly less expensive than traditional marketed securities offerings, which often involve an agent or underwriting fee of 3% or more, and are generally priced at a discount to the then-current market price of the issuer's securities. In contrast, securities in an ATM offering are sold at the prevailing market price and involve an agent's fee of 2% or less.

The beneficial features of ATM offerings include the fact that issuers have greater flexibility to better time the market by enabling them to sell their securities when the price is high and to cease distribution when the price falls. Each issuance under an ATM offering is comparable to an ordinary brokerage transaction except that the agents in the offering place the sell order on the relevant exchange or marketplace. As such, the agents in an ATM offering generally do not engage in any special marketing efforts or road shows, which can reduce the burden on management associated with a more traditional offering.

ATM offerings are very common in the United States, but have been much less frequent in Canada due to limitations imposed by our securities laws that necessitate that an issuer obtain exemptive relief in order to effect an ATM offering. In Canada, only short-form-prospectus-eligible issuers can effect ATM offerings, as the issuer must have a base shelf prospectus in place qualifying the issuance of the securities to be offered in the ATM offering, and a prospectus supplement relating to the ATM offering. ATM offerings can be ongoing over the entire period that the issuer's base shelf prospectus is effective, but involve a high degree of monitoring and a significant administrative burden for the reporting issuer. The prospectus supplement pursuant to which the ATM offering is made must contain full true and plain disclosure of all material facts on each date on which securities are sold under the ATM offering (which may require updating the supplement). Sales on any given day can represent no more than 25% of the securities traded on the relevant Canadian marketplace or exchange on such date.

In June 2017, TransCanada Corporation (TransCanada) obtained exemptive relief (TransCanada Relief) from the Canadian Securities Administrators (CSA) that reduced certain aspects of the administrative burden imposed on Canadian issuers in connection with ATM offerings. The TransCanada Relief provides a better template for issuers with significant market capitalizations to effect simultaneous ATM offerings on effectively the same basis in Canada and the United States – something that has not previously been possible for dual-listed issuers and has often resulted in such issuers effecting their ATM offerings exclusively in the United States.

TRADITIONAL ATM OFFERINGS IN CANADA

As discussed above, to establish an ATM offering, an issuer must have an effective base shelf prospectus pursuant to National Instrument 44-102 (NI 44-102). A dedicated prospectus supplement is then filed

ATM offerings are very common in the United States, but have been much less frequent in Canada due to limitations imposed by our securities laws that necessitate that an issuer obtain exemptive relief in order to effect an ATM offering.

by the issuer qualifying the securities to be sold in the ATM offering. Part 9 of NI 44-102 confirms that ATM offerings can be conducted in Canada, subject to the limitations that no more than 10% of the aggregate market value of the issuer's outstanding equity securities of the relevant class can be distributed pursuant to the ATM offering and that the agents in the offering, including anyone acting on their behalf, cannot over-allot the securities or effect transactions intended to stabilize or maintain the market price of the securities sold in the ATM offering.

Notwithstanding the permissive language contained in Part 9 of NI 44-102, reporting issuers and the agents acting in connection with the ATM offering are still required to obtain exemptive relief from certain requirements of securities legislation applicable to all prospectus offerings, such as:

– the obligation imposed on agents in an offering to deliver a hard copy of the prospectus to purchasers in an offering in Canada; and

– the statutory rights of rescission and withdrawal available to a purchaser in a prospectus offering in Canada who does not receive a copy of the prospectus.

Each of these requirements would be impractical in the context of an ATM offering where the agents, selling through a stock exchange, do not know the identity of the purchasers on the other side of their trades. As a condition of granting the required exemptive relief, Canadian securities regulators have typically imposed conditions, one of which is the requirement to disclose monthly in a report filed on SEDAR the number and average selling price of the securities distributed in the ATM offering, the commission payable to the agents, and the gross and net proceeds for such sales. Not only does this obligation increase the reporting obligations of the issuer, but it has the potential to contribute to speculation as to why issuers with an operative ATM offering may not have been selling securities in a particular month.

Sales cannot be made under an ATM offering when a material fact or material change relating to the issuer is not disclosed in or incorporated by reference into the prospectus supplement. This could include the intention of the issuer to sell a number of securities pursuant to the ATM offering on any particular day or over a certain period. Each time a new material fact or material change arises, distribution under the ATM offering must cease until that material fact or material change is disclosed in the issuer's continuous disclosure documents or the prospectus supplement is amended to include disclosure relating to the material change or material fact. Historically, this feature of ATM offerings limited the utility of the ATM offering, as issuers were often hesitant to amend their prospectus supplements and would generally wait to disclose the new material fact in their continuous disclosure documents prior to recommencing sales under the ATM offering.

As a condition of granting the exemptive relief required in order to permit ATM offerings to proceed in Canada, the CSA also imposes a condition that no more than 25% of the volume of securities traded on a Canadian marketplace on a day on which sales are made pursuant to an ATM offering can be as a result of sales under the ATM offering.

TRANSCANADA GETS NOVEL EXEMPTIVE RELIEF

The TransCanada Relief has modified the traditional framework for ATM offerings in Canada in two principal ways:

– Reporting on the securities sold in the ATM offering, including the number of securities sold, average price, commission payable and gross and net proceeds, can be made in the issuer's quarterly and annual filings, instead of in a separate monthly report.

– The prospectus supplement can incorporate by reference a new category of continuous disclosure document, referred to in the TransCanada Relief as a "designated news release," which can be used to update the prospectus supplement so that it contains full, true and plain disclosure of all material facts.

The quarterly reporting of sales and the designated press release procedures provided for in the TransCanada Relief enable TransCanada to conduct ATM offerings in Canada and the United States on effectively the same basis. The designated press release procedure will allow Canadian issuers to incorporate material facts into their ATM offering prospectus supplements in a manner that is analogous to the way that domestic U.S. issuers would update their registration statements using current reports filed with the U.S. Securities and Exchange Commission on Form 8-K. As a result, the TransCanada Relief will generally be utilized by Canadian reporting issuers that make use of the multijurisdictional disclosure system and are dual-listed in Canada and the United States.

The TransCanada Relief is available only to issuers that have significant market capitalizations, as the CSA has conditioned the availability of such relief on being able to satisfy a fairly onerous test to confirm that the securities to be issued in the ATM offering are actively traded prior to commencement of the ATM offering. As a result, smaller Canadian issuers will be stuck in the traditional ATM offering exemptive relief regime with its attendant continuous disclosure and reporting burdens.

Since the TransCanada Relief was granted on June 23, 2017, there has been an increase in the pace of Canadian reporting issuers applying for exemptive relief to commence an ATM offering. A number of these issuers have obtained the same exemptive relief that TransCanada obtained, while others have obtained the traditional relief or a combination of the traditional relief combined with relief from the monthly reporting obligation or the ability to use the designated press release procedures originated in the TransCanada Relief.

The TransCanada Relief will generally be utilized by Canadian reporting issuers that make use of the multijurisdictional disclosure system and are dual-listed in Canada and the United States.

FUTURE LEGISLATIVE AMENDMENTS TO FACILITATE ATM OFFERINGS

On April 6, 2017, while TransCanada was in the process of negotiating to obtain the TransCanada Relief, the CSA released Consultation Paper 51-404, *Considerations for Reducing Regulatory Burden for Non-Investment Fund Reporting Issuers*. In this paper, the CSA recognized the regulatory burden associated with Canadian ATM offerings and noted the disparity between the number of ATM offerings conducted in Canada versus in the United States. The CSA noted that industry participants have expressed a view that this disparity is partly a result of the need to obtain exemptive relief to effect an ATM offering in Canada. The consultation paper solicited feedback from participants in the Canadian capital markets on measures, including potential legislative amendments, to streamline and make ATM offerings more accessible for Canadian reporting issuers.

On March 27, 2018, the CSA announced its intention to initiate a policy project aimed at facilitating ATM offerings. We will be watching to see how the CSA proposes to achieve this goal. For the time being, the TransCanada Relief is a beneficial development that should enhance the utility of ATM offerings and lessen the administrative burden for certain Canadian issuers considering an ATM offering as an attractive method of accessing the Canadian capital markets.

CHAPTER 07

Bordering on Modern: Will Ontario's New Offshore Offering Rules Inspire a National Solution?

In 2016, the Ontario Securities Commission (OSC) took a big first step toward fixing Canada's problematic framework for regulating offshore offerings when it first proposed OSC Rule 72-503 *Distributions Outside of Canada*. In December 2017, the OSC took a further step when it published a new and improved version of that rule, which took effect on March 31, 2018.

While not perfect, the final version of OSC Rule 72-503 is an effective and practical solution for most common offshore offerings by Ontario-based issuers. However, there remains the glaring issue of its scope – it applies only in Ontario and therefore is *not* a national solution.

In each province and territory, the term "distribution" is broadly defined without express limitation on its territorial scope.

THEY KEEP ON PUSHING THEIR LAWS OVER THE BORDERLINE

It is surprisingly unclear when an issuer must address Canadian securities legislation for a primary securities offering made outside Canada. The main culprit: the principles-based "distribution" trigger that Canadian provinces and territories apply to identify trades in securities to which their prospectus requirements apply.

In each province and territory, the term "distribution" is broadly defined without express limitation on its territorial scope. Mindful of this omission in the law, some provincial securities regulators published guidance to clarify when offshore offerings might constitute a distribution. However, this guidance was unclear and incomplete and, ultimately, outdated. The provinces of Alberta and British Columbia also implemented local rules intended to provide more certainty through bright-line tests, but these rules have proven to be impractical and unhelpful in most circumstances.

This uncertainty is further complicated by the absence of a harmonized approach for regulating offshore offerings across Canada. Each province and territory has its own approach, which generally falls within one of two categories:

– **"Distribution-in" jurisdictions** (like Ontario). In these jurisdictions, an offering is a distribution only if made to investors in the jurisdiction or, due to certain connecting factors with the jurisdiction, there is a reasonable likelihood that the offered securities will flow back into the jurisdiction without first coming to rest outside the jurisdiction.

– **"Distribution-out" jurisdictions** (like British Columbia). In these jurisdictions, any offering *from* the jurisdiction is also a distribution. An offshore offering may be *from* a jurisdiction if the issuer has certain substantial connections to the jurisdiction without regard to whether these factors actually contribute to flow-back risk.

This stark contrast in approach is due to fundamentally different views about the purpose of the prospectus requirement. Generally speaking, the distribution-in approach affords prospectus-related protections only to investors located in that jurisdiction, on the basis that investors outside the jurisdiction will expect to rely on the equivalent protections afforded to them under their own foreign securities legislation.

In contrast, the distribution-out approach suggests that the prospectus-related protections should be afforded to all investors (regardless of their location) that acquire securities from an issuer with substantial connections to that jurisdiction.

ONTARIO'S NEW RULE PROVIDES SOME CROSS-BORDER ORDER

Although right in principle, Ontario's old offshore offering regime was still a problem in practice. Its biggest failure was the absence of any bright-line tests or "safe harbours" to clearly exclude or exempt bona fide offshore offerings from inappropriate application of Ontario's prospectus requirement. This was further complicated by Ontario's antiquated guidance (in Interpretation Note 1, *Distributions of Securities Outside Ontario*), which often conflicted with its own animating principle and introduced unnecessary ambiguity.

OSC Rule 72-503 has fixed the issue for the most part. Its key feature is its new exemptions, which provide issuers with the certainty they need for most common offshore offerings. Now, in cases where it's unclear if an offshore offering is a "distribution" in Ontario, an issuer may simply confirm that it satisfies the objective conditions of one of Rule 72-503's new exemptions. Remarkably, these new exemptions aren't focused on whether the traded securities will come to rest outside Canada. Instead, they broadly address circumstances in which the OSC has determined that Ontario's prospectus-related protections are not necessary to fulfil the purposes of Ontario's securities laws.

The new companion policy to OSC Rule 72-503 also helps. It confirms and further clarifies Ontario's distribution-in approach to identifying offshore offerings that constitute a distribution. Critically, it did not carry forward the irrelevant connecting factors and outdated and impractical flow-back precautions previously contained in the old Interpretation Note.

In cases where it's unclear if an offshore offering is a "distribution" in Ontario, an issuer may simply confirm that it satisfies the objective conditions of one of Rule 72-503's new exemptions.

HOW OSC RULE 72-503 STACKS UP AGAINST THE INITIAL PROPOSAL

In response to comments from Davies and other market participants, some important improvements and corrections were reflected in the final version of OSC Rule 72-503. However, with one key difference, it is fundamentally the same as the initial 2016 rule proposal (summarized in our 2017 Capital Markets Report). Generally speaking, primary securities offerings to purchasers in jurisdictions outside Canada are exempt from Ontario's prospectus requirement if the issuer has materially complied with (or is exempt from) that foreign jurisdiction's disclosure requirements for the offering and the issuer satisfies any other conditions of one of the four available exemptions.

The cleanest of the four exemptions are (i) the foreign public offering exemption (whereby the issuer registers or qualifies that foreign offering with a public offering document in the United States or one of the other specified foreign jurisdictions) and (ii) the concurrent Ontario public offering exemption (where, concurrently with the offshore offering, the issuer qualifies a public offering in Ontario). Neither impose any further conditions or require any reporting. The third exemption – which allows for other offshore offerings by a reporting issuer – still requires a post-closing report, but no longer requires that the issuer have a minimum four-month reporting history.

The key difference from the original 2016 proposal is in the fourth exemption, which allows for offshore offerings by non-reporting issuers. In the final rule, the OSC removed a provision that would have allowed for bona fide offshore resales of securities initially purchased under the fourth exemption. The OSC removed this resale provision in the interest of harmonizing resale regimes across Canadian jurisdictions. In its place, the OSC has amended OSC Rule 72-503 to include two (more limited) exemptions for offshore resales of securities of certain foreign non-reporting issuers. These two exemptions are substantially the same exemptions that have been adopted in each other Canadian jurisdiction via a national instrument. The second exemption is the result of a recent initiative of the Canadian Securities Administrators to modernize and harmonize offshore resale rules across Canada, and will come into force on June 12, 2018.

WHAT IS PREVENTING A NATIONAL FRAMEWORK FOR OFFSHORE OFFERINGS?

If Canadian securities administrators can agree on a harmonized framework for offshore *resales,* why can't they do the same for offshore *offerings*? We have asked this question repeatedly. We can only speculate that it is due to fundamentally different views of certain jurisdictions about the purpose of the prospectus requirement. Specifically, distribution-out jurisdictions (like British Columbia) are reluctant to scale back to the modern distribution-in approach applied in Ontario.

Ironically, British Columbia is the only other jurisdiction that has implemented modern offshore offering exemptions along the lines of those in OSC Rule 72-503. These exemptions are a significant step forward for British Columbia. Unfortunately, they are more limiting than their Ontario counterparts because they fail to accommodate the improvements and corrections that the OSC made to OSC Rule 72-503 in 2017. Moreover, in many cases, the B.C. exemptions require more detailed post-trade reporting, which adds unnecessary cost and, where individual purchaser information is required, may conflict with the privacy expectations of certain foreign purchasers.

While OSC Rule 72-503 and the corresponding exemptions in British Columbia each mark a vast improvement over the prior offshore offering regimes in those jurisdictions, they do not constitute a harmonized national framework for primary offshore offerings. From our perspective, this is a significant disappointment. A fractured approach to offshore securities regulation doesn't belong in a modern world, where the stated objective of Canadian securities regulators is to promote more efficient and competitive capital markets.

CHAPTER 08

Ontario Clearing Agency Regime to Be Extended to Registered Dealers

In May 2017, the Ontario government announced amendments to the *Securities Act* (Ontario) that would have the effect of requiring some registered dealers to register to be recognized as clearing agencies. This change is an expansion of the scope of the existing rules: registered dealers are not currently subject to the clearing agency regime.

After the new rules come into effect, registered dealers will be required either to apply to be recognized as a clearing agency (and comply with the rules applicable to clearing agencies) or to obtain an exemption from doing so if they engage in any of the following activities:

- acting as an intermediary in paying funds or delivering securities;
- providing centralized facilities for the clearing of trades and other transactions in securities; or
- providing centralized facilities as a depository of securities.

Recognized clearing agencies are required to establish, implement and maintain rules, procedures, policies or operations designed to ensure that they meet or exceed specified standards published by the International Organization of Securities Commissions. They must also comply with specific governance standards; implement procedures to identify and address risks; and maintain books and records in accordance with the rules. In addition, recognized clearing agencies are subject to restraints on, among other things, the unreasonable prohibition or limitation of access to their services or discrimination among their participants.

A registered dealer that engages in clearing agency activities may find these rules difficult to comply with in the context of its business, which is not primarily that of a clearing agency. Registered dealers that will be caught by the regime as a result of the proposed amendments may wish to consider applying for an exemption from the recognition requirement. Exemptive relief may be available for persons that are not considered "systemically important" or that do not otherwise pose significant risks to capital markets. To date, such relief has been granted to other market participants on the basis of the applicant agreeing to develop and maintain adequate systems for internal controls in respect of their clearing agency activities and to abide by some basic annual reporting and record-keeping obligations.

The Ontario government has not indicated when it expects the revised clearing agency rules to come into effect. The uncertainty of the timing for implementation is particularly troubling because the revised rules do not include a transition period in which registered dealers would have an opportunity to apply for exemption or recognition orders. While it is possible that a transition period may be included in the final legislation to address concerns that have been raised with the Ontario Securities Commission, registered dealers that will be impacted by the change may wish to reach out to the commission sooner rather than later to discuss the timing and nature of a possible exemption or recognition order.

Registered dealers that will be caught by the regime as a result of the proposed amendments may wish to consider applying for an exemption from the recognition requirement.

SEC Rulemaking Developments in 2017

Within the first hundred days of taking office, President Trump reiterated his commitment to scaling back existing financial regulations. In February 2017, President Trump signed into law Congress's repeal of the extractive industry transparency rules adopted by the U.S. Securities and Exchange Commission (SEC) in June 2016. These rules would have required all SEC reporting issuers, 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. Additionally, in February 2017, President Trump signed an executive order establishing core principles to guide his administration's regulation of the U.S. financial system and directed the U.S. Department of the Treasury to report on laws and regulations that inhibit regulation of the U.S. financial system in a manner consistent with the core principles. In response, the U.S. Department of the Treasury issued recommendations to promote access to capital, among other things, through reducing regulatory obligations and modernizing the U.S. capital markets regulatory structure and processes.

The SEC's proposed and final rules issued in 2017 focus primarily on improving the readability, navigability and accuracy of disclosure documents.

Despite these recommendations, 2017 was a fairly quiet rulemaking year for the SEC. The SEC's proposed and final rules issued in 2017 focus primarily on improving the readability, navigability and accuracy of disclosure documents.

This update provides an overview of the following U.S. securities law and regulatory developments in 2017. Although some of these rules are applicable only to U.S. issuers, we believe these developments should be of interest to market participants abroad, as well as Canadian issuers and their advisers.

1. FAST ACT MODERNIZATION AND SIMPLIFICATION OF REGULATION S-K

As required by the *Fixing America's Surface Transportation Act*, the SEC is proposing amendments to Regulation S-K based on the recommendations made in the SEC staff's Report on Modernization and Simplification of Regulation S-K, released in the last quarter of 2016. Regulation S-K sets forth the content requirements of the non-financial statement portions of certain registration statements, annual reports and other documents under U.S. securities law. The proposed amendments are intended to modernize and simplify certain disclosure requirements in Regulation S-K and related rules and forms, as well as reduce the costs and burdens on registrants and improve the readability and navigability of disclosure documents.

2. SEC FILINGS MUST INCLUDE HYPERLINKS TO EXHIBITS AND BE IN HTML FORMAT

New rules of the SEC that require exhibits to be hyperlinked in most SEC filings became effective on September 1, 2017. Under the new rules, registrants that are filing a registration statement or current report that is subject to the exhibit requirements under section 601 of Regulation S-K or that are filing a Form F-10 or 20-F must insert a hyperlink to each exhibit listed in the exhibit index of such filing. The final rules do not require Canadian issuers to include hyperlinks to exhibits in any multijurisdictional disclosure system (MJDS) form filed with the SEC or any Form 6-K furnished to the SEC. The final rules also require all filings covered by the rules to be in the HTML format to support hyperlinks.

3. INLINE XBRL FILING OF TAGGED DATA

The SEC is proposing amendments that are intended to facilitate improvements in the quality and usefulness of eXtensible Business Reporting Language (XBRL) data and decrease filing costs by decreasing XBRL preparation costs over time. The proposed amendments would require financial statement information to be provided in the Inline XBRL format, which, in practical terms, means that filers would be required to embed XBRL data directly into an HTML formatted filing.

4. SEC RESOURCE EXTRACTION RULE ELIMINATED BY CONGRESSIONAL ACTION

On February 14, 2017, President Trump signed a joint resolution of the House of Representatives and the Senate eliminating the resource extraction issuer payment disclosure rule of the SEC.

5. SEC STATEMENTS RELATING TO CONFLICT MINERALS DECISION

On August 18, 2015, the U.S. Court of Appeals for the District of Columbia Circuit held that the Dodd-Frank rule that requires public companies to investigate and disclose the origin of certain minerals (conflict minerals) found in the Democratic Republic of the Congo (DRC) and countries bordering the DRC violates the U.S. Constitution's protection of free speech under the First Amendment.

6. SEC GUIDANCE ON PAY RATIO DISCLOSURE

On September 21, 2017, the SEC adopted interpretive guidance to assist domestic reporting companies in their efforts to comply with the pay ratio disclosure required by item 402 of Regulation S-K under the *Securities Act of 1933*, as amended. On the same day, the SEC staff provided separate guidance on calculating the pay ratio disclosure. Domestic reporting companies must begin providing pay ratio disclosure for the first time in early 2018 for the fiscal year beginning on or after January 1, 2017.

7. SEC APPROVES AN NYSE RULE AMENDMENT PROHIBITING RELEASE OF MATERIAL NEWS AFTER MARKET CLOSE

On December 4, 2017, the SEC approved an NYSE rule amendment – revised Rule 202.06 – prohibiting NYSE-listed companies from releasing material news after the NYSE's official trading closing time (NYSE Closing Time) until the earlier of (i) the publication of a company's official closing price on the NYSE and (ii) five minutes after the NYSE Closing Time. The rule amendment, which became effective on December 7, 2017, is intended to reduce price discrepancies between the official closing price on the NYSE and the prices of execution in other exchanges and non-exchange venues.

For a more in-depth look at these rule changes, see www.dwpv.com/SEC-Rulemaking.

Contributors

Steven J. Cutler
Toronto office

Scott D. Fisher
New York office

Mindy B. Gilbert
Toronto office

Brooke Jamison
Toronto office

Peter Martorelli
Toronto office

Nicolas Morin
Montréal office

Robert S. Murphy
Toronto office

Jeffrey Nadler
New York office

Patricia L. Olasker
Toronto office

Geoffrey L. Rawle
Toronto office

Zain Rizvi
Toronto office

Sébastien Roy
Montréal office

Robin Upshall
Toronto office

David Wilson
Toronto office

Key Contacts

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.

Mindy B. Gilbert

mgilbert@dwpv.com
416.367.6907

Olivier Désilets

odesilets@dwpv.com
514.841.6561

Jeffrey Nadler

jnadler@dwpv.com
212.588.5505

About Davies

Davies is a law firm focused on high-stakes matters. Committed to achieving superior outcomes for our clients, we are consistently at the heart of their largest and most complex deals and cases. With offices in Toronto, Montréal and New York, our capabilities extend seamlessly to every continent. Contact any of our lawyers to talk with us about your situation.

Visit us at dwpv.com.

DAVIES

TORONTO

155 Wellington Street West
Toronto ON Canada
M5V 3J7

416.863.0900

MONTRÉAL

1501 McGill College Avenue
Montréal QC Canada
H3A 3N9

514.841.6400

NEW YORK

900 Third Avenue
New York NY U.S.A. 10022

212.588.5500

DAVIES WARD PHILLIPS & VINEBERG LLP