

C | Securities Law and Corporate Governance



1. Overview

Canada currently does not have a federal securities regulator like other major capital markets. Rather, each province and territory has its own securities regulatory authority and its own set of laws, regulations, rules and policies. The 13 provincial and territorial securities regulators work together to harmonize regulation across the country through rules known

as “national instruments.” Also, issuers can often rely on a “passport” system that allows them to deal directly with only one or two regulators.

Concerns over the cumbersome and costly nature of the decentralized system of securities regulation has led to calls for a national system. Currently, the Canadian government is working toward establishing a national securities regulatory system, the constitutionality of which is currently before the Supreme Court of Canada, with a decision anticipated by the end of 2011.

2. Distribution of Securities

In Canada, a distribution of securities cannot be completed without:

- The filing of a prospectus; and
- A registered dealer to effect the distribution.

These requirements are intended to protect investors. A prospectus is a comprehensive disclosure document providing detailed information on the issuer’s business and the securities being offered. The requirement of a registered dealer helps ensure that securities are sold by honest, reputable people.

Frequently, reporting issuers (i.e., public companies) circumvent compliance with prospectus and registration requirements by distributing securities to “accredited investors” (i.e., institutional or individual investors who meet a certain threshold of net worth).

Private corporations in Canada often avoid prospectus and registration requirements by relying on a “private issuer” exemption. This exemption applies in cases where the corporation has fewer than 50 shareholders, the distribution is not made to the public and restrictions on transfer are imposed on the corporation’s securities.

3. Listing in Canada

The Toronto Stock Exchange (TSX) and the TSX Venture Exchange (TSX-V) are the two major Canadian public stock exchanges.

In Canada, opportunities exist for corporations to go public and access the capital markets at a much earlier stage than in other markets, such as the U.S. In particular, the TSX-V has a flexible tiered system with varying levels of listing requirements, which, in certain circumstances, can facilitate listing at the pre-revenue stage. Many non-Canadian corporations list in Canada as a stepping stone toward listing in the U.S.

4. Initial Public Offerings

The process for completing an initial public offering (IPO) in Canada generally takes three to four months. An issuer is required to file a preliminary prospectus with securities regulators, followed by a final prospectus that contains “full, true and plain disclosure of all material facts” related to its business and the securities being offered. The prospectus must include three years of audited financial statements prepared in accordance with International Financial Reporting Standards (IFRS) or the Generally Accepted Accounting Principles (GAAP) of the U.S. with a reconciliation to IFRS. Securities regulators are required to provide their comments within 10 business days of the date the preliminary prospectus is filed. The issuer is not permitted to file a final prospectus until all comments from regulators are settled.

An issuer planning a public offering in multiple Canadian jurisdictions will generally rely on the “passport” system when filing its prospectus. Under the passport system, a prospectus filed and cleared with the issuer’s principal regulator is automatically valid in the other provincial regulatory systems.

An issuer that lists in Canada through an initial public offering or direct listing, or that otherwise becomes a reporting issuer in Canada (e.g., through acquisition of a Canadian public company by way of share exchange), will be required to comply with Canadian requirements on timely and periodic disclosure, financial reporting and corporate governance, as well as the policies of the exchange on which its securities are listed.

5. Continuous Disclosure Requirements

A reporting issuer’s continuous disclosure obligations fall into two categories: timely disclosure of material information; and periodic disclosure consisting of quarterly and annual financial statements, quarterly and annual management’s discussion and analysis, an annual information form (for TSX issuers) and shareholder meeting materials.

Canadian securities legislation also requires insiders of reporting issuers to report their security holdings and any direct and indirect transactions involving those holdings. In Canada, reporting issuers are required to file their offering and continuous disclosure documents on www.sedar.com, which is a free electronic database for investors and others.

The principal requirement for timely disclosure is that a reporting issuer issue and file a press release “forthwith” when a material change in its affairs occurs or when material information relating to its affairs becomes known to management. A “material change” is a change in the business, operations or capital of the reporting issuer that would reasonably be expected to have a significant effect on the market price or value of any of the securities of the reporting issuer. The definition also includes situations where a decision to

implement a change referred to above is made by the board of directors or other persons acting in a similar capacity, or by senior management of the reporting issuer who believe that confirmation of the decision by the board of directors, or such other persons acting in a similar capacity, is probable.

6. Civil Liability

Breach of timely and continuous disclosure requirements, including misrepresentation in publicly disclosed communications, can result in regulatory proceedings against a reporting issuer.

Possible consequences include: being placed on a list of defaulting reporting issuers, maintained by most securities regulatory authorities; a temporary or permanent cease-trading order being issued by the securities regulatory authorities; or delisting by the TSX or the TSX-V.

In some Canadian jurisdictions, investors can sue reporting issuers for damages for misrepresentations in a publicly disclosed communication (such as a prospectus or public oral statement) or failure to make timely disclosure. Plaintiffs are deemed to have relied on either the misrepresentation or on the reporting issuer having complied with its disclosure obligations.

However, provincial securities laws do set limits on liability and provide for defences. A leave of the court is required for an action to proceed; court approval is required for settlements, and costs are awarded to the prevailing party as determined by the court.

Aside from the reporting issuer, directors and officers of the reporting issuer and other persons who knowingly influence the release of a misrepresentation can be found liable. Generally, defendants can escape liability for misrepresentation in a publicly disclosed communication if they prove that:

- Before the release of the information containing the misrepresentation, the defendant conducted or

caused to be conducted a reasonable investigation;
and

- At the time of the release, the defendant had no reasonable grounds to believe the document or statement contained the misrepresentation.

Similarly, for breaches of timely disclosure obligations, a defendant can avoid liability by showing that before the failure to make timely disclosure first occurred, the defendant conducted or caused to be conducted a reasonable investigation, and that the defendant had no reasonable grounds to believe that the failure to make timely disclosure would occur.

7. Financial Reporting Requirements

Each year, issuers listed on the TSX must file audited annual comparative financial statements accompanied by an auditor's report with the securities regulators within 90 days of their financial year-end. For issuers listed on the TSX-V, the time period is 120 days. The board of directors must approve these financial statements before they are filed.

The preparation of interim comparative financial statements is required on a quarterly basis and must be filed with the securities regulators within 45 days of the end of the financial period for TSX-listed issuers and within 60 days for issuers listed on the TSX-V.

A reporting issuer is required to deliver annual or interim financial statements to security holders only upon request, provided the reporting issuer has sent a request form to each security holder.

8. Shareholder Meetings

A meeting of shareholders must be held each year, generally not later than six months following the corporation's fiscal year-end.

In keeping with corporate law, a corporation must generally mail a notice of a shareholder meeting to all reg-

istered shareholders entitled to vote at the meeting, to the directors of the corporation and to the auditors at least 21 days prior to the meeting. The notice and all attachments related to the meeting must be mailed concurrently to all holders of non-voting equity securities. Along with the notice, corporations are also required to provide a management information circular describing the matters to be voted on at the meeting along with proxy voting instructions.

9. Expedited Public Financings and Private Placements

Reporting issuers that have established a minimum 12-month continuous disclosure record in Canada are generally eligible to file a "short form" prospectus, which enables them to complete a public equity financing on an expedited basis.

A short form prospectus describes the securities being offered and, by reference, incorporates certain materials previously prepared and publicly disclosed by the issuer, such as an annual information form, management information circular, material change reports and financial statements. The short form prospectus can usually be cleared by securities regulators across Canada in one week or less.

10. Prospectus-exempt Distributions

Certain exemptions permit issuers to distribute securities without filing a prospectus. These exemptions most notably include distributions to accredited investors and distributions of securities with an acquisition cost to the purchaser of not less than \$150,000 in cash.

Examples of accredited investors include:

- Institutional investors, such as registered investment advisers and dealers, financial institutions, governments and government agencies, insurance companies, pension funds and investment funds; and

- Individuals and corporations with certain minimum income or financial assets.

There are also prospectus exemptions for certain non-financing distributions such as securities exchange take-over bids and distributions made in connection with a business combination or a reorganization transaction.

11. Early Warning Reporting

A person who acquires 10 per cent of the voting or equity securities of a reporting issuer (including convertible securities and rights to acquire voting or equity securities) is required to comply with the “early warning” provisions of Canadian securities law. These provisions include the obligation to issue a press release and to file an early warning report.

The purpose of the early warning report is to disclose to the market that a particular investor holds a significant ownership stake in the reporting issuer and to provide information on the investor’s intentions with respect to the investment.

Further reports are required for each additional 2 per cent of the voting or equity securities acquired. Once a person acquires 20 per cent of the voting securities of a reporting issuer, the person must comply with the take-over bid rules of Canadian securities law with respect to all further acquisitions of such securities.

12. Take-over Bids

Where a person (or group of persons acting in concert) offers to acquire voting or equity securities of any class of issuer that, together with outstanding securities already owned, exceeds 20 per cent of the outstanding voting or equity securities of such class, the acquisition will constitute a take-over bid.

Generally, a take-over bid circular is mailed to all shareholders and filed with the applicable securities regulators. The take-over bid circular describes the

offer and provides prospectus-level disclosure relating to the offeror and the securities being offered (where the consideration is securities).

A minimum threshold for shareholder support is a typical condition of a take-over bid, with 66 $\frac{2}{3}$ per cent and 90 per cent being the most common support thresholds. A support level of 66 $\frac{2}{3}$ per cent is common for many transactions under corporate law, including amalgamations where the acquirer can eliminate the remaining shareholders who have not tendered their shares under the take-over bid. Usually, when the 90 per cent threshold is met, the acquirer can take ownership of the remaining shares by way of a compulsory acquisition.

There are very few exemptions from the take-over bid rules. The most commonly used exemption requires that securities be purchased by private agreement from no more than five people at a price not exceeding 115 per cent of the market price of the securities. Generally, the market price is equal to the average closing price of the securities on the stock exchange during the 20 trading days preceding the date of the agreement. Another exemption permits the purchase of no more than 5 per cent of a class of securities during any 12-month period at prices not exceeding the market price of the securities.

13. Insider Reporting

Directors, chief executive officers, chief financial officers, chief operating officers and significant shareholders (those with more than 10 per cent of the voting shares) of reporting issuers and their subsidiaries are generally considered to be “reporting insiders.” Consequently, certain reporting obligations are imposed on them under Canadian securities law.

Reporting obligations are intended to provide the marketplace and regulators with disclosure relating to a reporting insider’s direct or indirect beneficial ownership, control or direction over securities of the reporting issuer. A person must file publicly available reports



within 10 days of becoming a reporting insider and within five days of subsequent changes in security ownership.

14. Insider Trading and Tipping

Insider trading involves buying or selling a security of a reporting issuer with knowledge of material information about the reporting issuer that has not been publicly disclosed. Tipping involves providing material undisclosed information to a person other than in the necessary course of business.

Insider trading and tipping are serious offences and conviction in Ontario can result in a fine of up to \$5,000,000, imprisonment for up to five years less a day and/or banishment from trading in securities. Defendants have a defence to an insider-trading or tipping allegation if they prove that they reasonably believed that such material information had been generally disclosed.

15. Corporate Governance

In response to the U.S. *Sarbanes-Oxley Act* of 2002, Canada's securities regulatory authorities released a series of corporate governance-related instruments in mid-2003.

TSX-listed issuers are required to have an audit committee composed of at least three directors, all of whom must be "independent" and "financially literate." Issuers listed on the TSX-V are required to have an audit committee composed of at least three directors, the majority of whom must be "independent" and "financially literate."

Securities laws in Canada set out a list of non-binding corporate governance guidelines that reporting issuers are encouraged to consider in developing their own practices. While compliance with the guidelines is voluntary, mandatory disclosure is imposed on reporting issuers with respect to whether or not their corporate governance practices comply.

Other corporate governance recommendations include:

- Adoption of a board consisting of a majority of independent directors with an independent chair or lead director, and with the independent directors holding regularly scheduled meetings at which non-independent directors and members of management are not in attendance;
- Adoption of a written board mandate that includes recommendations relating to the board's functions and responsibilities;
- Development of clear position descriptions for the chair of the board, the chair of each board committee and the chief executive officer;
- Adoption of a written code of business conduct and ethics;
- Appointment of nominating and compensation committees composed entirely of independent directors; and
- Adoption of a written charter.

16. Québec

Documents of a contractual nature, such as prospectuses and take-over bid circulars (tender offers materials), must be translated and sent to Québec residents in French. Québec is also the only jurisdiction in Canada that currently has specific legislation regulating derivatives.

17. Dealer, Adviser and Investment Fund Manager Registration Requirements and Exemptions

Any person or company that engages in (or holds itself out as engaging in) the business of trading in securities in Canada (including acting in furtherance of a trade, such as the marketing of securities) must be registered as a dealer in each province or territory where the business activities are undertaken.

Alternatively, a person or company registered as a broker or dealer in their home jurisdiction may rely on an "international dealer" exemption, which, subject to certain pre-notification filings (and the payment of an annual fee if trading in Ontario), generally permits a dealer to trade in non-Canadian securities to Canadian institutional investors and ultra-high-net-worth individuals.

The administrative fund managers of Canadian investment funds (including private hedge funds) must be registered as investment fund managers and meet certain minimum risk-free capital, insurance and other compliance requirements.

Portfolio managers with Canadian clients must be registered as advisers in the Canadian jurisdictions where the clients reside. Portfolio managers registered in this manner, or those that are exempt from registration in their home jurisdictions, may rely on an "international adviser" exemption, which, subject to certain pre-notification filings (and the payment of an annual fee if advising Ontario clients), generally permits them to act for institutional investors and ultra-high-net-worth individuals, as long as less than 10 per cent of their revenue is derived from Canadian clients.

gowlings: expect innovation, results and value

Founded in 1887, Gowlings is one of Canada's largest law firms, with over 750 professionals in offices across the country and in Moscow, London and Beijing. Recognized for excellence in business, advocacy and intellectual property law, Gowlings provides dedicated industry expertise in the energy, mining, infrastructure, life sciences, government, financial services, technology, manufacturing and distribution sectors, and in areas such as corporate finance and M&A, transfer pricing and tax, patents and trade-marks, and occupational health and safety. For more information, visit

gowlings.com/dbic

This publication is part of Gowlings' *Doing Business in Canada* guide, which provides business executives, foreign counsel and investors with an overview of the legal aspects of Canadian business operations. The information in this guide is current as of September 2011 and is for general information purposes only. It does not constitute a legal opinion or other professional advice.

For further information or to view the rest of the guide, please visit us at gowlings.com/dbic.

montréal • ottawa • toronto • hamilton • waterloo region • calgary • vancouver • beijing • moscow • london • gowlings.com

Gowlings provides legal services in Canada and abroad through the entities Gowling Lafleur Henderson LLP, Gowling Lafleur Henderson S.E.N.C.R.L., s.r.l., Gowlings (UK) LLP, and Gowlings International Inc. In 2011, the firm opened the Gowlings International Inc. Beijing Representative Office. © 2011 Gowlings