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CSA Proposes Changes to Make Rights Offerings More Attractive to Reporting Issuers

Rights offerings allow issuers to raise capital while providing existing security holders with the opportunity to avoid dilution of their holdings. Unless an exemption is available, a rights offering must be made pursuant to a prospectus prepared in accordance with applicable Canadian securities laws. While a prospectus-exempt rights offering is theoretically appealing, in reality the associated time and cost of these distributions has led to issuers rarely making use of this exemption. In light of this, on November 27, 2014, the Canadian Securities Administrators (the "**CSA**") published for a 90-day comment period proposed amendments to the current prospectus-exempt rights offering regime, designed to make these offerings more attractive to issuers. The CSA intends to achieve this goal by creating a streamlined prospectus exemption for rights offerings conducted by issuers other than investment funds (the "**Proposed Exemption**").[1]

Also on November 27, 2014, the Ontario Securities Commission announced rule amendments that will provide a new prospectus exemption for distributions by reporting issuers (other than investment funds) listed on certain Canadian exchanges to their existing security holders. Our commentary on these amendments can be found *here*. These amendments and the Proposed Exemption

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[1] Ontario Securities Commission, CSA Notice and Request for Comment, "Proposed Amendments to National Instrument 45-106 *Prospectus and Registration Exemptions*, National Instrument 41-101 *General Prospectus Requirements*, National Instrument 44-101 *Short Form Prospectus Distributions*, and National Instrument 45-102 *Resale Restrictions* and Proposed Repeal of National Instrument 45-101 *Rights Offerings*" (27 November 2014) online: OSC <*http:/www.osc.gov.on.ca*>.

are part of the efforts by Canadian securities regulators to make it easier for issuers to raise capital in the exempt market.

Prospectus-Exempt Rights Offerings Today

Currently, prospectus-exempt rights offerings in Canada are governed by section 2.1 of National Instrument 45-106 *Prospectus and Registration Exemptions* ("**NI 45-106**") and must comply with the requirements of National Instrument 45-101 *Rights Offerings* ("**NI 45-101**"). Under NI 45-106, in order to utilize the exemption, a rights offering circular must be filed and reviewed by CSA staff. Additionally, NI 45-106 restricts issuers from issuing more than 25% of their securities in any 12-month period. Research conducted by the CSA over the past year found that the overall time period to conduct these prospectus-exempt rights offerings was much longer than offerings under other prospectus exemptions, resulting in increased costs and a lack of certainty. The CSA also found that the 25% dilution limit restricted issuers with small market capitalization from being able to raise enough funds to make a rights offering worthwhile. The CSA is now trying to address these concerns through the Proposed Exemption, so that rights offerings may become more accessible and more widely utilized in the Canadian securities market.

Key Changes Under the Proposed Exemption

Changes to Disclosure Requirements:

> <u>Notice</u>: In order to make use of the Proposed Exemption, reporting issuers would first need to file and send to security holders a notice (the "**Notice**") before the commencement of the exercise period of the rights. The Notice, which is anticipated to be no more than two pages long, would contain basic disclosure about the offering and inform security holders on how to access the rights offering circular (the "**Circular**") electronically.
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> <u>Circular</u>: The Circular would have to be filed concurrently with the Notice and would be formatted as a set of questions and

answers presenting information about the offering, the use of funds available and the financial condition of the issuer in a manner that is easier for issuers to prepare and for investors to understand. Pursuant to Canadian securities laws, when a rights offering circular contains scientific or technical information relating to a mineral project on a property material to the issuer, the issuer must file a technical report on such project unless certain exceptions apply. However, the Proposed Exemption does not require technical or business disclosure in a Circular, so issuers would only trigger the requirement to file a technical report if they choose to include technical disclosure in the Circular. Additionally, while issuers must certify that the Circular contains no misrepresentations, they would not have to send a copy of it to security holders under the Proposed Exemption.

No Review Before Use: In a move that would lead to significant time savings, CSA staff would not review the Notice or the Circular prior to use. Instead, certain regulators would conduct reviews of Circulars in their jurisdictions for a period of two years after the Proposed Exemption is adopted, in order to examine how issuers are using the Proposed Exemption and to ensure that issuers are complying with its conditions. To ensure overall compliance, CSA staff would conduct continuous disclosure reviews of issuers on an ongoing basis.

Closing News Release: Issuers would be obligated to file a closing news release that must contain prescribed information about the rights offering. Proposed items to be included in the news release include the aggregate gross proceeds and the amount of securities distributed under each of the basic subscription privilege, the additional subscription privilege and any stand-by commitment.

Increased Dilution Limit: The CSA proposes to increase the dilution limit from the current 25% to 100% under the Proposed Exemption. This would mean that an issuer could issue up to 100% of its securities under prospectus-exempt rights offerings in any 12-month period.

Protections for Security Holders: Under the Proposed Exemption, issuers would have a new duty to make the basic subscription privilege available on a *pro rata* basis to all security holders of the class of securities to be distributed on exercise of the rights. In addition, statutory secondary market civil liability for secondary market disclosure provisions would apply to the acquisition of securities in a rights offering under the Proposed Exemption. This would give investors a right of action in respect of a misrepresentation of an issuer's continuous disclosure documents, including the Circular.

Subscription Pricing: Issuers listed on a published market would have to set the subscription price for a right at a price that is lower than the market price at the time of filing of the Notice. The CSA believes that the discount from market price would encourage more participation from retail security holders. Issuers not listed on a published market must ensure that the subscription price for their rights offering is lower than fair value at the time of filing of the Notice. The Circular requires that an explanation be provided as to the basis for determining fair value and Companion Policy 45-106CP to NI 45-106 notes that an issuer may consider preparing a fairness opinion or valuation to meet the disclosure obligation. In recognition of the fact that it may be difficult or expensive for unlisted reporting issuers to prove fair value, this provision would not apply if insiders of the unlisted issuer are restricted from increasing their proportionate interest in the offering through the exercise of rights under the offering or a stand-by commitment.

No Exemption for Non-Reporting Issuers: In an effort to simplify the current landscape of prospectus-exempt rights offerings, the CSA has decided to repeal the prospectus exemption for rights offerings by non-reporting issuers. Specifically, the CSA proposes the repeal of section 2.1 of NI 45-106 and NI 45-101 and the withdrawal of Companion Policy 45-101CP to NI 45-101. The CSA believes that this exemption is no longer warranted as non-reporting issuers do not provide sufficient disclosure for an investor to make an informed investment decision and have rarely utilized the rights offering exemption.

Stand-By Exemption: The CSA proposes a new prospectus exemption for securities issued to a stand-by guarantor as part of a distribution under the Proposed Exemption, if such stand-by guarantor acquires the security as principal. If the stand-by guarantor is a security holder as at the date of the Notice and is not a registered dealer, it would be permitted to acquire securities under the Proposed Exemption with only a seasoning period of resale. The CSA is currently considering whether these securities should also be subject to a restricted period on resale, consistent with the approach taken with securities acquired by stand-by guarantors who are not security holders of the issuer on the date of the Notice or who are registered dealers.

by Sandra Zhao and Devina D'Silva, Student-at-Law

For more information please contact:

Toronto	Sandra Zhao	416.865.7808	sandra.zhao@mcmillan.ca

a cautionary note