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RAISING CAPITAL IN MINING? PRACTICAL CONSIDERATIONS FOR PRIVATE PLACEMENTS

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Canada has historically been and continues to be a leading international hotspot for mining finance. With the resurgence of precious metals prices in 2020, coupled with the recent decline in market interest in the cannabis and cryptocurrency sectors, there is an immediate opportunity for Canadian exploration and development companies of all stages to raise capital on favourable terms to advance existing projects or to acquire new projects. In recent years, there has been a notable increase by mining issuers in raising equity by means of private placements ("**Private Placements**") as compared to public offerings.[1] Advantages of proceeding by way of a Private Placement rather than by public offering include lower transaction expenses, minimal involvement by securities regulators and commonly, a shorter time from commencement of the financing to completion. However, as Canadian securities laws impose a 4-month resale restricted period on securities issued by way of Private Placements, subscribers (other than for tax-advantaged flow-through shares) will generally require that the Private Placement be completed at a discount to the current market price of the issuer's shares and may require that additional 'sweeteners' (such as warrants to acquire equity) be included to compensate the investor for the temporary loss of liquidity. If you are a junior mining issuer considering raising capital by way of Private Placement, here are some practical considerations:

Brokered vs. Non-brokered Offering

As an initial consideration, an issuer must assess whether it can raise sufficient capital to achieve its business objectives through its existing networks, in which case a non-brokered private placement may be feasible. An issuer proceeding by means of a non-brokered offering must be careful that its actions do not result in the issuer or its employees being found to be engaging in, or holding themselves out as engaging in, the business of trading securities, as such actions give rise to the requirement that the issuer and the relevant employees be registered under applicable securities legislation. While there is no bright line test, generally issuers with an active non-securities business are not required to register as a securities dealer if they do not hold themselves out as being in the business of trading, trade in securities infrequently, are not or do not expect to be compensated for trading in securities, do not act as intermediaries and do not produce or intend to produce a profit from trading in securities. For employees of issuers who solicit investors, if those activities are incidental

to such employees' primary roles with the issuer, they will likely not be considered to be in the business of trading provided that they are not compensated for raising capital, the majority of their time is not spent in raising capital and the principal purpose of their employment is not to raise capital.

Alternatively, and particularly where larger amounts of funds are required, it may be appropriate to engage a registered securities dealer (a "**Dealer**") to assist with the Private Placement, making it a brokered financing. In some instances, a combined brokered and non-brokered offering may be feasible. Although a brokered financing requires an issuer to pay participating Dealers a commission of cash and frequently, securities, a brokered offering typically increases the pool of capital the issuer would otherwise be able to access in a non-brokered offering and has the additional benefit of communicating to the investment community that the issuer has the support of one or more reputable investment banks. In addition, given recent renewed market confidence in the mining sector, issuers are increasingly receiving offers for "bought-deal" financings from Dealers prepared to underwrite Private Placements, thereby largely transferring the risk of completion of the financing from the issuer to the underwriting Dealers.

Whether brokered or non-brokered, the issuer will be required to rely on a prospectus exemption under National Instrument 45-106 – *Prospectus Exemptions* and the comparable exemptions under the *Securities Act* (Ontario). The exemption most frequently relied on by smaller mining issuers continues to be the "accredited investor" exemption (the "**AI Exemption**").[2] While there are a number of categories of "accredited investors", individuals most commonly meet the test by having: (a) financial assets (alone or with a spouse) with an aggregate realizable value before taxes but net of any related liabilities exceeding $1 million; (b) net assets (alone or with a spouse) of at least $5 million; or (c) a net income before taxes that has exceeded $200,000 (or if combined with a spouse, has exceeded $300,000) in each of the 2 most recently completed calendar years together with a reasonable expectation that net income will exceed the applicable threshold level in the current calendar year. Issuers have an obligation to conduct reasonable diligence to determine whether an investor qualifies as an "accredited investor". Requiring representations in the subscription agreement and the completion of investor questionnaires by the investor may not always be sufficient to satisfy the diligence requirement, particularly where an issuer makes no effort to ensure that potential investors understand the requirements of the AI Exemption and fails to seek supporting information from potential investors whose ability to qualify under the AI Exemption is in question. Dealers can be of great assistance to issuers making this assessment as a result of their need to satisfy their own "know your client" regulatory obligations. In deliberating on the choice of proceeding by way of a brokered or non-brokered financing, an issuer should consider its capacity to conduct the requisite due diligence on its own, including its willingness to request and its ability to obtain personal financial information from potential investors as evidence of such investors' qualification under the AI Exemption.

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Flow Through vs. Non-Flow Through Offerings

Mining issuers will need to consider whether the securities offered in the Private Placement should be issued as traditional equity or as equity issued on a "flow through" basis, which will depend on what the issuer intends to spend the proceeds of the financing on, as well as on prevailing market conditions. "Flow through" financings permit investors to deduct up to the entire purchase cost of the equity acquired from issuers from such investors' income for tax purposes provided the issuer expends the proceeds from the financing on certain prescribed exploration and development expenses for Canadian projects.

It is quite common for mining companies, particularly at the early stages of exploration, to not have any net income for tax purposes. As a result, such companies will often not be able to fully deduct the amount of their exploration expenditures in computing their income for several years, and in some cases may never be in a position to fully benefit from such deductions. In this regard, Canada's flow-through share regime permits certain mining companies that are willing to forego the tax benefit associated with the deduction of exploration expenses to "renounce" such expenses to investors acquiring flow-through shares in certain circumstances.

Investors acquiring flow-through shares from a corporation are allowed to deduct the amount of "Canadian exploration expenses" (as defined in the *Income Tax Act* (Canada) (the "**Tax Act**")) that the corporation has incurred, and which have been renounced to them by the corporation, against other sources of income. As a consequence of having renounced its exploration expenses in favour of investors, the corporation loses the ability to deduct such expenses in computing its income. However, as mentioned above, where a corporation does not anticipate having any significant amount of net income subject to tax for several years, the present day value of these deductions may not be material. As a result, flow-through share offerings have proven to be an effective way for mining companies to raise funds for certain types of exploration and development activities in Canada and, in many cases, shares issued pursuant to "flow-through" financings can be priced at a premium to the prevailing market price of the listed shares due to the tax benefit they provide to investors.

In order for shares to qualify as an issuance of flow-through shares, several conditions must be met, including (but not limited to) that: (i) the issuer be a "principal business corporation" (as defined in the Tax Act, but which generally means that the issuer's principal business must be mining or exploring for minerals), (ii) there be a written agreement (a "**Subscription Agreement**") between the issuer and the investor governing the issuance of the shares, (iii) the flow-through shares meet certain conditions (these are fairly complex, but essentially the shares must be "ordinary" common shares that fully participate in the risks and benefits of the corporation's activities, and such shares cannot be subject to any terms or agreements that effectively reduce an investor's risk), and (iv) the issuer must incur the exploration expenses to be renounced within certain time limitations.

There are two rules that govern the applicable time limitations for incurring the expenses, a "general rule" and a "look-back rule". Under the general rule, the issuer must incur the exploration expenses within 24 months of the date on which the Subscription Agreement is entered into. Such expenses can be renounced to an investor after the expenses have been incurred and before March of the first calendar year that begins after this 24-month period. Under the look-back rule, based on a commitment to incur the exploration expenses in the calendar year that immediately follows the one in which the Subscription Agreement is entered into, the issuer can renounce the exploration expenses to investors effective December 31 of the year in which the Subscription Agreement was entered into, despite not having yet incurred the expenses at the time of renunciation. Under the look-back rule, the issuer will be subject to additional taxes in respect of amounts renounced but for which eligible expenditures have not yet been incurred and, should the issuer fail to incur the expenditures renounced by the end of the year following the year of the Subscription Agreement, investors may be subject to retroactive adjustments to their tax payable.

In response to the Covid-19 pandemic, on July 10, 2020, the Department of Finance (Canada) announced certain changes to the rules applicable to flow-through shares, including that corporations issuing flow-through shares will be granted an additional 12 months under both the general rule and the look-back rule to incur the exploration expenses to be renounced to investors. Under the general rule, the 12-month extension would apply to Subscription Agreements entered into on or after March 1, 2018 and before 2021. Similarly, under the look-back rule, the 12-month extension would apply to Subscription Agreements entered into in 2019 or 2020.

Marketing Materials

Issuers need to consider whether marketing materials will be necessary to successfully market the proposed financing. While no marketing materials or offering documents are required in order to rely on the AI Exemption, if any "offering memorandum" is delivered to any prospective purchaser in connection with the financing, certain provinces (Ontario, Saskatchewan, New Brunswick and Nova Scotia and if reliance is being had on the minimum subscription amount exemption, Alberta) require that the document be filed with the securities regulators within 10 days following the distribution of securities. "Offering memorandum" is broadly defined in the securities legislation as being any document purporting to describe the business and affairs of an issuer that has been prepared primarily for delivery to and review by a prospective purchaser so as to assist the prospective purchaser to make an investment decision in respect of a security to be sold pursuant to a prospectus exemption. Previously prepared annual reports, financial statements or management's discussion and analysis will not qualify as "offering memorandum" since they were not prepared primarily to assist prospective investors. However, a private placement memorandum, investor deck or an electronic presentation could be caught within the definition of offering memorandum. Providing an "offering memorandum" to

potential investors will generally give rise to additional disclosure requirements, including disclosure of the existence of statutory rights of action for rescission or damages. More significantly, misrepresentations in an offering memorandum will give rise in certain provinces (Ontario, Manitoba, Saskatchewan, Nova Scotia, New Brunswick, Newfoundland and Labrador, Prince Edward Island and all three territories) to statutory rights of the purchaser to rescind the trade or to seek damages. In Private Placements intended to be broadly marketed through the use of an offering memorandum, it has also become a common market practice for issuers to grant contractual rights of rescission or damages to investors resident in British Columbia, Alberta and Quebec comparable to the statutory rights available to investors in the other Canadian provinces and territories. Given the broad definition of what constitutes an offering memorandum, issuers should be careful not to inadvertently trigger regulatory requirements arising therefrom and if the requirements are found to have been triggered, to immediately take necessary steps to satisfy their regulatory obligations.

Be Prepared

As market conditions change rapidly, it is critical that issuers take appropriate steps to prepare for a financing well in advance of the time when funding may be necessary. Appropriate preparation includes ensuring that all of the issuer's continuous disclosure filings have been made in a compliant manner, the issuer's financial models are up to date and any consents of third parties required for an issuer to conduct a Private Placement have been obtained. The need for consent may arise under the terms of outstanding loans or credit facilities, the terms of participation agreements entered into with existing shareholders and the terms of agreements with Dealers from prior financings which may prohibit or restrict additional financings by the issuer for a fixed period or which may provide such Dealers with the right to lead or to participate in subsequent financings by the issuer. In addition, issuers should pre-emptively create and regularly update a virtual due diligence platform, fully populating it with relevant due diligence materials. This will enable Dealers to complete diligence on the issuer in an efficient manner, thereby increasing the speed with which a Private Placement may be marketed.

Technical Reports and Keeping the QP in the Loop

All disclosure of scientific or technical information, including disclosure of mineral resources or reserves concerning a mineral project or property material to the issuer, is required by National Instrument 43-101 *Standards of Disclosure for Mineral Projects* ("NI 43-101") to be based on information prepared by or under the supervision of a qualified person (a "**QP**") or approved by a QP. The identity of such QP and the QP's relationship to the issuer must be included in all written disclosure. Accordingly, mining issuers preparing for a Private Placement should ensure that the relevant QP is available if it anticipates that as part of the Private Placement, disclosure in investor presentations, news releases, term sheets or other disclosure documents or on the issuer's website, will include content requiring a QP's preparation, supervision or approval.[3]

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Mining issuers should carefully assess whether intended disclosure relating to the Private Placement or the intended use of proceeds from the Private Placement will require the issuer to file an updated technical report pursuant to NI 43-101. Any written disclosure that discloses for the first time mineral reserves or resources or the results of a preliminary economic assessment or a change in any of the foregoing from that disclosed in the issuer's most recent technical report, in each instance on a property material to the issuer and which constitutes a material change in relation to the issuer, will give rise to the obligation to file a new technical report. This obligation frequently arises as a result of the issuer complying with its continuous disclosure obligations and publicly disclosing material information on its existing properties shortly in advance of, or concurrently with, the announcement of the intended Private Placement. The requirement to file a new technical report may also arise when the issuer reaches an agreement to acquire a property and intends to use the proceeds of the Private Placement to fund the acquisition. Where disclosure concerning the property intended to be acquired would trigger the obligation to file a new technical report if such property had then been owned by the issuer, then subject to limited exceptions, the issuer will be obligated to file a new technical report within 45 days of this initial disclosure, even though in some instances the acquisition may only be at the letter of intent stage or be subject to the satisfaction of numerous conditions prior to completion.

Location of Investors

Mining issuers and their counsel should consider at the outset where the Private Placement is to be marketed and where potential investors are located to ensure the form of subscription agreement being used to distribute securities under the Private Placement complies with the applicable securities laws of each jurisdiction where the issuer may sell securities. Issuers should undertake a cost benefit analysis to determine whether the amount of capital potentially accessible from investors in countries outside of Canada exceeds the additional compliance costs incurred relating to distributing securities into each additional jurisdiction. These costs may include filing fees payable in such additional jurisdictions and the cost of retaining local legal counsel. Issuers may require local counsel to confirm, and significant offshore investors may require that the issuer obtain a legal opinion confirming, that the distribution of securities to the investor in its country of residence complies with the securities laws of that country, which may extend the time needed to complete the Private Placement as well as increasing costs.

If you have any questions regarding junior or mid tier issuer mining issuer Private Placements, members of McMillan's *Capital Markets Group* and *Mining Group* would be pleased to assist you.

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[1] The Prospectors & Developers Association of Canada publication, "State of Mineral Finance 2019: at the Crossroads" reported equity raised by mineral companies listed on Canadian stock exchanges by means of

private placements increased from 31% of the total equity raised in 2013 to 76% of the total equity in 2018.[ps2id id='1' target=''/]

[2] The 2018 Ontario Exempt Market OSC Staff Notice 45-716 reported that small Canadian mining firms relied predominantly on the "accredited investor" exemption to raise capital and that in 2017, this exemption was used by 88% of these issuers and accounted for 83% of the capital raised.[ps2id id='2' target=''/]

[3] CSA Staff Notice 43-309 *Review of Website Investor Presentations by Mining Issuers* released in April 2015 reported that a review of 130 investor presentations available on mining issuers' websites indicated that 25% had major non-compliance and an additional 57% had minor non-compliance with the requirements of NI 43-101.[ps2id id='3' target=''/]

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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