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Canadian developments affecting cross-border offerings of securities

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With cannabis companies dominating the headlines in 2018, it was easy to overlook other Canadian developments affecting capital markets activities. In this article, we focus on key developments impacting cross-border offerings of securities, including several rules which together facilitate the distribution and resale of securities outside of Canada, something akin to "Regulation S" in the United States. We also highlight certain considerations applicable to U.S.-only initial public offerings (IPOs) by Canadian issuers as well as an important difference between Canadian and U.S. practice relating to the ability to confidentially submit a draft prospectus in connection with an offering.

Safe harbours for distributions of securities to investors outside of Canada

Canada has no general equivalent to U.S. Regulation S, which allows offerings outside the United States to proceed without registration with the U.S. Securities and Exchange Commission (SEC). As a result, determining whether a Canadian prospectus requirement applies to a distribution of securities from Canada to investors outside of Canada can be a complicated exercise. Canadian prospectus requirements and resale restrictions can give rise to unwanted compliance issues when Canadian issuers or selling securityholders look to distribute securities to investors in a foreign jurisdiction without filing a prospectus in Canada. This arises, for example, in a U.S.-only IPO or Rule 144A offering of high yield debt.

In British Columbia, Alberta and Québec, the securities regulators take the position that the sale of securities by an issuer or selling securityholder in that province to investors outside of the province is subject to their prospectus requirements. In most cases, issuers with a head office in one of those provinces or with other significant connecting factors to that province have been required to either file a prospectus in the province or rely on a prospectus exemption, even when the issuer or selling securityholder is distributing securities to investors primarily or entirely outside of Canada. The position in Ontario has historically been less clear (see our discussion of the reasons in Proposed OSC Rule 72-503 to modernize framework for distributions of securities outside of Ontario).

The adoption in March 2018 of OSC Rule 72-503 – Distributions Outside Canada (the Ontario Rule) was considered to be a significant legal development affecting capital markets transactions because of the clarity it provided with respect to when a prospectus is required for treasury or secondary distributions of securities from Ontario to investors outside of Canada. The Ontario Rule provides four safe harbours where the Ontario prospectus requirement will not apply to a distribution of securities to investors outside of Canada:

- **Distributions under public offering document in foreign jurisdictions (section 2.1):** Distributions where the issuer is conducting a public offering in the United States or a specified foreign jurisdiction,
- **Concurrent distribution under final prospectus in Ontario (section 2.2):** Distributions where the issuer has filed a prospectus in Ontario and the issuer or selling securityholder has materially complied with foreign disclosure requirements applicable to the distribution or is exempt from such requirements,
- **Distributions by reporting issuers (section 2.3):** Distributions where the issuer is a reporting issuer in a jurisdiction of Canada immediately preceding the distribution and the issuer or selling securityholder has materially complied with foreign disclosure requirements applicable to the distribution or is exempt from such requirements, and
- **Distributions by non-reporting issuers (section 2.4):** Distributions by a non-reporting issuer if the issuer has materially complied with foreign disclosure requirements applicable to the distribution or is exempt from such requirements.

Significantly, no Canadian four-month hold period will apply to securities distributed outside of Canada in reliance on the safe harbours, except where the issuer is not a reporting issuer in Canada. The table below outlines some common situations where it may be useful to rely on the safe harbours in the Ontario Rule:

	Safe harbour under the Ontario Rule	Canadian four-month hold period	Trade report required (Form 72-503F)
Treasury offerings			
U.S.-only IPO: Ontario-headquartered issuer carrying out a U.S.-only IPO (no prospectus filed in Canada) [e.g., issuer using Form F-1 or S-1 with no public offering in Canada]	s. 2.1	No	No
U.S.-only public offering: Ontario-headquartered U.S.-listed or dual-listed issuer carrying out a public offering of common shares in the U.S. (no prospectus filed in Canada) [e.g., issuer using a WKSI shelf or Form F-3 or S-3 shelf rather than an MJDS shelf on Form F-10]	s. 2.1	No	No
Foreign private placement concurrent with Canadian public offering: Ontario-headquartered Canadian-listed issuer carrying out a private placement of common shares in the U.S., Europe, UK, Asia or elsewhere outside of Canada concurrent with a Canadian public offering (prospectus filed in Ontario) [e.g., a typical Canadian bought deal]	s. 2.2	No	No

Foreign private placement: Ontario-headquartered Canadian-listed issuer carrying out a private placement of common shares in the U.S., Europe, UK, Asia or elsewhere (no prospectus filed in Canada)	s. 2.3	No	Yes
U.S. debt offering by public company: Ontario-headquartered Canadian-listed issuer carrying out a private placement of high yield or convertible debt in the U.S. (no prospectus filed in Canada) [e.g., U.S.-style 144A debt offering with U.S. offering memorandum]	s. 2.3	No	Yes
U.S. debt offering by private company: Ontario-headquartered private company carrying out a private placement of high yield debt in the U.S. (no prospectus filed in Canada) [e.g., U.S.-style 144A debt offering with U.S. offering memorandum]	s. 2.4	Yes	Yes
Secondary offerings			
U.S.-only IPO: Ontario-headquartered selling shareholder selling shares in a U.S.-only IPO (no prospectus filed in Canada) [e.g., issuer using Form F-1 or S-1 with no public offering in Canada]	s. 2.1	No	No
U.S.-only public offering: Ontario-headquartered selling shareholder of U.S.-listed or dual-listed issuer selling shares in a public offering of common shares in the U.S. (no prospectus filed in Canada) [e.g., issuer using a WKSI shelf or Form F-3 or S-3 shelf rather than an MJDS shelf on Form F-10]	s. 2.1	No	No
Foreign private placement concurrent with Canadian public offering: Ontario-headquartered selling shareholder of Canadian-listed issuer carrying out a private placement of common shares in the U.S., Europe, UK, Asia or elsewhere outside of Canada concurrent with a Canadian public offering (prospectus filed in Ontario) [e.g., a typical Canadian bought deal]	s. 2.2	No	No

Issuers and selling securityholders offering securities in a distribution from Ontario to investors outside of Canada do not have to rely on the safe harbours in the Ontario Rule. It is still open to determine that Ontario prospectus requirements do not apply to a distribution of securities outside of Canada as long as sufficient measures are taken to prevent "flowback" of the securities to Canada. The Companion Policy to the Ontario Rule sets out some examples of measures that may be taken in order to prevent flowback, including obtaining representations and warranties from non-Canadian investors that they are purchasing securities with investment intent and not with a view to distribution. We believe it is not necessary to take these measures if an issuer or selling securityholder is relying on one of the safe harbours in the Ontario Rule, meaning there is no need to obtain Ontario-specific representations and warranties from non-Canadian investors in those cases.

The Ontario Rule applies where the issuer or selling securityholder has a head office in Ontario or there are other significant factors that result in Ontario laws applying to the distribution of securities. If the issuer or selling securityholder has a head office in, or other significant connecting factors to, any of the provinces of British Columbia, Alberta or Québec, other laws and rules apply, such as B.C. Instrument 72-503 – Distribution of Securities Outside British Columbia (the British Columbia instrument) and Alberta Securities Commission Rule 72-501 – Distributions to Persons Outside Alberta. The British Columbia instrument and Alberta rule have been updated relatively recently to be more consistent with the Ontario Rule, although there are some important differences between the rules. For instance, under the British Columbia instrument, it may still be necessary to obtain specific representations from non-Canadian investors participating in a private placement that they are purchasing as principal. In addition, under the instrument, the securities of a reporting issuer issued to a non-Canadian investor in a private placement will be subject to a four-month hold period. Under the Alberta rule, there are exemptions from the four-month hold period for non-reporting issuers similar to sections 2.14 and 2.15 of National Instrument 45-102 – Resale of Securities (NI 45-102), which are discussed below.

In Québec, prospectus exemptions for distributions outside the province may be obtained by way of exemptive relief from the Autorité des marchés financiers – sometimes referred to as a "section 12" order. Issuers should allow two weeks lead time (or more, depending on the circumstances) in Québec for obtaining a section 12 order.

Resale exemptions for securities purchased by Canadian investors in international offerings

Accredited investors in Canada frequently have the opportunity to purchase securities in what are primarily non-Canadian offerings, such as a U.S. or international offering by a non-Canadian issuer. These types of international offerings may be extended to investors in Canada on a private placement basis, most commonly using the "accredited investor" exemption. Canadian investors in most jurisdictions of Canada now have two alternatives for freely reselling securities purchased by them on a private placement basis in what are primarily non-Canadian offerings: the existing section 2.14 and new section 2.15 of NI 45-102. These resale exemptions are very important, as many Canadian investors would not purchase securities in an international offering without the ability to freely resell their securities at any time.

Canadian investors purchasing securities in an international offering have historically relied on section 2.14 of NI 45-102, which provides an exemption for resales of securities outside of Canada as long as the issuer is not a reporting issuer in Canada and the Canadian shareholder base of the issuer is at or below 10%, measured by the total number of shares held by Canadian residents as well as the total number of Canadian resident owners of shares. However, section 2.14 is not available for issuers that are listed on a Canadian stock exchange or that have a large Canadian shareholder base, such as many technology and high growth companies with broad pre-IPO share ownership.

Canadian investors in most jurisdictions of Canada now also have the ability to rely on new section 2.15 in addition to section 2.14 of NI 45-102. Section 2.15 is also meant to apply to issuers that have a minimal connection to Canada, and is available for resales of securities of a "foreign issuer" that is not a reporting issuer in Canada. In order to be a foreign issuer, the issuer's head office must be outside of Canada and a majority of the issuer's executive officers as well as a majority of its directors must reside outside of Canada. This resale exemption is useful because the exemption does not require the Canadian investor to determine the level of Canadian share ownership of the issuer and also applies even if the Canadian shareholder base is in excess of the 10% thresholds. As with section 2.14 of NI

45-102, section 2.15 is not available for issuers that are listed on a Canadian stock exchange or are otherwise a reporting issuer in Canada.

The availability of the resale exemptions in section 2.14 or section 2.15 of NI 45-102 will continue to be a key factor in determining whether Canadian investors will participate in international offerings by non-Canadian issuers. These resale exemptions may also be available for securities of Canadian issuers that have Canadian share ownership at or below the specified 10% thresholds or that qualify as a "foreign issuer", as long as the issuer is not listed on a Canadian stock exchange or is otherwise a reporting issuer in Canada.

Considerations for U.S.-only IPOs by Canadian issuers

Some Canadian issuers may decide to carry out a U.S.-only IPO, which involves a public offering in the United States and a U.S. stock exchange listing, with no public offering in Canada or Canadian stock exchange listing. These issuers may feel that the benefits of being listed in Canada do not outweigh the burden of compliance with additional Canadian public company requirements. In our view, these incremental Canadian compliance requirements should not discourage Canadian issuers from pursuing a Canadian listing and public company status in Canada. U.S.-only IPOs in fact give rise to a number of issues that should be carefully considered.

First, as described above, Canadian prospectus requirements may apply to the distribution of securities to non-Canadian investors in the IPO, even if there is no intention to conduct a public offering in Canada. This will be the case particularly if the head office of the issuer is located in British Columbia, Alberta, Québec or Ontario. If Canadian prospectus requirements apply, the issuer will be required to either file a prospectus in the province or rely on a prospectus exemption if one is available, such as one of the safe harbours discussed above.

Second, and more importantly, the issuer needs to consider whether both existing Canadian pre-IPO shareholders as well as new Canadian investors purchasing shares in the IPO will have the ability to freely resell their shares. This ultimately comes down to whether either of the resale exemptions in section 2.14 of section 2.15 of NI 45-102 is available. Without one of these exemptions, both Canadian pre-IPO shareholders as well as any Canadian investors purchasing shares in the IPO on a private placement basis will generally be "stranded" with shares subject to permanent Canadian hold periods.

Some Canadian issuers with significant Canadian share ownership have had to file a non-offering prospectus in Canada in connection with their IPO in order to facilitate the free resale of shares by Canadian pre-IPO shareholders. While section 2.15 of NI 45-102 is now also available as an alternative to section 2.14, we believe section 2.15 will be unavailable for many Canadian issuers since they will not meet the requirements of having a head office outside of Canada or the requirements for non-Canadian residency applicable to executive officers and directors. As a result, filing a non-offering prospectus may still be the only way to achieve free resale of shares by Canadian pre-IPO shareholders. Filing a non-offering prospectus, however, will not eliminate the four-month hold period applicable to shares purchased by Canadian investors in the IPO if shares are only being offered to Canadian investors on a private placement basis. For this reason, if a Canadian non-offering prospectus will be required to facilitate resale by Canadian pre-IPO shareholders, or if there is a desire to facilitate participation in the IPO by investors in Canada, a cross-border IPO with a regular Canadian prospectus and a Canadian listing should be considered.

Confidential submissions of draft Canadian prospectuses

Canadian issuers have become accustomed to being able to confidentially submit a Canadian prospectus for review by a principal regulator in connection with a cross-border IPO. This is possible where the issuer is able to confidentially submit its U.S. registration statement with the SEC. The ability to confidentially submit a draft prospectus in Canada has been limited to cross-border IPOs, as there is no general ability in Canada to confidentially submit a draft prospectus for review by Canadian securities regulators.

In July 2017, the SEC expanded the scope of its confidential registration review process, including by making confidential submission and review available to issuers of all sizes, rather than only emerging growth companies under the U.S. Jobs Act and certain foreign private issuers. At the same time, the SEC also allowed issuers to confidentially submit draft registration statements for SEC review for follow-on and secondary offerings made within one year of their initial registrations. Previously, confidential review in the United States was limited to issuers undertaking an IPO. As a result of this change, U.S. issuers now frequently rely on the ability to confidentially submit a registration statement for a follow-on or secondary offering in the one year period following their initial registration. (After this one year period, many U.S. issuers will then become eligible to use "shelf" registration procedures, eliminating the benefit of confidential submission and review.) This has resulted in a major difference between Canadian and U.S. offering practice, as we understand that Canadian securities regulators have not moved to allow for the confidential submission and review of a Canadian prospectus other than in connection with a cross-border IPO.

Take for instance a Canadian dual-listed issuer that is contemplating a secondary offering by a selling shareholder in the one year period following its initial registration. Since July 2017, the typical U.S. practice for executing a registered equity offering has been to confidentially submit with the SEC a draft of the registration statement on Form S-1 or F-1 in advance of launch of the equity offering, with the goal of obtaining a "no review" indication from the SEC. Once this no review has been confirmed, the registration statement is publicly filed and the equity offering is launched, with pricing to occur as soon as possible thereafter (at least 48 hours after public filing). In Canada, there is no ability to confidentially submit a draft prospectus for review other than in connection with a cross-border IPO. As a result, on a cross-border follow-on or secondary offering, the issuer could find itself in a position where the offering is ready to be priced, but the issuer has not yet cleared comments from Canadian regulators on its preliminary short form prospectus – an unacceptable situation from the perspective of deal execution.

This issue can be solved if the issuer has a Canadian-only shelf prospectus. However, in many cases, a dual-listed issuer will choose not to put up a shelf prospectus prior to the time at which it establishes a shelf in the United States. The other alternative is for the issuer to bypass Canada by carrying out a U.S.-only offering in reliance on one of the prospectus safe harbours discussed above. While this may facilitate execution of the offering, we view this as an unfortunate result of the divergence between Canadian and U.S. practice.