



PIPE Transactions in Canada

A practical guide to private investments
in Canadian public equities.

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The *PIPE Transactions in Canada* guide provides general information only and does not constitute legal or other professional advice. Specific advice should be sought in connection with your circumstances. For more information, please contact Osler's Corporate Group at counsel@osler.com.



Overview

This guide provides a high-level overview of private investments in Canadian public equities (PIPE), including common areas of negotiation, strategic rationale, typical deal terms and relevant regulatory and stock exchange approvals involved in such transactions. We invite you to contact the contributing editors of this guide or any other member of our Corporate practice group to discuss PIPE transactions.

A PIPE is a transaction between a public company and a qualified investor that involves a private placement of securities by the company to the investor. PIPEs are frequently accompanied by a negotiated package of investor rights and protections.

PIPE transactions can vary significantly in structure. In most cases, a PIPE will involve the issuance of common equity, although preferred equity, convertible securities, warrants or a combination of such securities may also be used.

There is no single blueprint for a PIPE. Each is the product of deal-specific objectives and dynamics. This guide summarizes common considerations and themes that we encounter regularly in negotiating PIPE transactions.



Strategic considerations

The company

There are several potential advantages to raising capital through a PIPE for companies to consider.

Developing a long-term and/or strategic relationship with a large shareholder

A PIPE can result in a block of shares being held by a strategically significant partner and may form part of a larger commercial relationship between the investor and the company. The block of shares may also act as a bulwark against potential activist investors or unsolicited bidders.

Alternative source of financing

A PIPE may provide companies with access to financing during periods of market volatility and turmoil when access to public capital markets may not otherwise be available on attractive terms.

Confidentiality

Typically, a PIPE will only be disclosed publicly after definitive agreements have been negotiated and entered into. There is no formal public offering or marketing process associated with a PIPE, which can reduce risks associated with stock price fluctuations.

Bespoke rights and protections

Subject to stock exchange rules and applicable securities laws, the parties may negotiate a broad range of rights and protections that govern the terms of the investment. For companies, these protections may include extended hold periods, standstills or voting support obligations imposed on the investor.

Quick access to capital on a controllable time frame

Given that a PIPE is typically negotiated directly between two parties and does not require the preparation of a disclosure document, PIPE transactions can often be concluded more quickly than other forms of capital raising.

Lower transaction expenses

Transaction costs for the company can be lower than many other financing alternatives.

There can also be certain disadvantages to raising capital through a PIPE.

Significant investor control

The relative size of the investment and negotiated investor rights may result in an investor acquiring influence over a company without providing liquidity to existing shareholders. This may limit the company's freedom to make certain business or operational decisions without consulting – or, in some instances, soliciting the approval of – the investor.

Discount to market price

Given the longer hold periods and associated lack of liquidity, investors may insist that the securities be issued at a discount to prevailing market prices.

Toehold may discourage future acquirors

The presence of a significant block of shares in the hands of a strategic investor may discourage future buyers from attempting to acquire the company.

The investor

There are distinct advantages to investing in a company through a PIPE that may not be available through other investment channels.

Favourable economic terms

A PIPE will often (but not always) be priced at a discount to current market prices to compensate the investor for a lack of immediate liquidity imposed by securities law and stock exchange hold periods. PIPE investments are sometimes also accompanied by warrants that provide the investor with an additional “sweetener.”

Opportunity to influence corporate strategy

An investor may negotiate governance (including board appointment) and approval, veto or consultation rights that provide it with influence over the company's go-forward strategy.

Additional investor rights and protections

An investor may negotiate additional rights and protections such as pre-emptive rights, registration rights and information rights. These rights can offer a level of investment monitoring and protection for public securities that more closely resemble those afforded to investors in private companies and may not otherwise be available to the company's broader shareholder base.

Structuring flexibility

An investor may wish to invest in preferred shares, debt securities or convertible securities on the basis that such securities may grant them preferential dividend entitlements, a liquidation preference over common shares and/or priority over equity securities.

Alternative to M&A

Investing in a company through a PIPE may allow the investor to realize some of the objectives of an acquisition without having to acquire the entire company. A PIPE may provide a pathway to a future acquisition of the company or may provide the investor with opportunity to generate a return.

Investing in a company through a PIPE may also include certain disadvantages.

Hold periods and standstills

An investor may be subject to extended hold periods for the securities that it acquires, as well as a standstill that prevents it from acquiring further securities or voting its securities against management.

Insider limitations

An investor that holds more than 10% of a public company, whether prior to or as of a result of the PIPE, will be subject to insider and early warning reporting requirements and may be subject to related party transaction restrictions. In addition, if the insider holds material non-public information, the investor may be precluded from trading in the company's securities under applicable insider trading restrictions.



Legal requirements

Process

The negotiation and implementation of a PIPE transaction typically involves three stages:

Pre-announcement period

Prior to announcement, the parties will enter into a confidentiality agreement and, in some instances, an exclusivity agreement. Both parties will typically engage legal counsel (internal and/or external) and may engage financial advisors. The investor and its advisors will then complete a due diligence review of the company, the scope of which will depend on the size of investment and the industry of the company, among other factors. The parties then negotiate and enter into a subscription or investment agreement, which will specify the terms of any new securities to be issued and any additional agreements to be entered into concurrently with and conditional on the closing of the PIPE transaction. Though less common, the parties may also use the pre-announcement period to file applications for conditional approval of the stock exchanges on which the company's securities are listed for trading or to seek pricing certainty through the price reservation mechanisms of applicable stock exchanges.

Post-announcement period

Following execution of the subscription or investment agreement, the parties will publicly announce the transaction and, if not already completed, file applications for conditional stock exchange approval and seek any shareholder or other regulatory approvals required in connection with the transaction. In cases where a new insider is created or a board seat is granted, there may be a need for a "personal information form" to be filed with and cleared by the stock exchange prior to closing. In our experience, the clearance of personal information forms and related background checks can sometimes lengthen the overall deal timeline and should be factored in accordingly.

Closing and post-closing period

Once all conditions to closing have been satisfied, including receipt of all stock exchange and regulatory approvals, the investor will pay the subscription price to the company and the transaction will close in accordance with the terms of the subscription agreement. Finally, post-closing filings with stock exchanges, securities regulators and other regulatory authorities are made, as required.

Prospectus and approval requirements

The availability and terms of a PIPE transaction are limited by provincial securities laws and stock exchange rules. The terms of a PIPE transaction will also determine the nature of any corporate approvals required of the issuing company.

Distribution rules

Securities distributed by a company must be qualified by a prospectus unless an exemption is available under applicable securities law. A company will therefore need to satisfy itself that a prospectus exemption is available prior to issuing securities as part of a PIPE transaction. This will necessarily be a fact-specific exercise and will depend on the profile of the investor. In the context of a PIPE transaction, we frequently see companies relying on the “accredited investor” exemption, which permits the sale of securities to a person or company with a minimum asset or income base on a prospectus-exempt basis.

Related party

In circumstances where a company seeks to complete a transaction with a related party, Multilateral Instrument 61-101 – *Protection of Minority Security Holders in Special Transactions* (MI 61-101) may impose additional disclosure and approval requirements on the PIPE transaction, including the need for approval by a majority of disinterested shareholders.

Similarly, an investor may become a related party after consummating a PIPE transaction, with the result that certain subsequent transactions or arrangements between the company and the investor may be subject to additional disclosure and approval requirements.

Corporate law

Under Canadian corporate law, the board of the company will need to conclude that the transaction is in the best interests of the corporation. If the proposed transaction contemplates the creation of a new class of shares, the articles of the corporation will have to be amended. The creation of a new class of shares is a fundamental change which, depending on the jurisdiction, may require a special resolution of shareholders (approval by two-thirds of the votes cast at a meeting of shareholders). The articles of a company will sometimes provide the ability to create new series of preferred shares without the need for obtaining shareholder approval.

Stock exchange rules

If the company is listed on the Toronto Stock Exchange (TSX), the company will be subject to the rules of the TSX that require, among other things, the company to provide immediate notice (Notice) to the TSX of any transaction involving the issuance of any of its securities other than unlisted, non-voting, non-participating securities. The Notice typically takes the form of a letter addressed to the TSX seeking its approval to list the new securities and includes a copy of the subscription agreement and any other agreements to be entered into in connection with the transaction. The company may not proceed with the proposed transaction unless and until approved by the TSX.

The TSX may require the company to seek and obtain shareholder approval as a condition to the TSX's approval of a transaction, if, in the opinion of the TSX, the transaction:

- materially affects the control of the company;
- provides consideration to insiders in aggregate of 10% or greater of the market capitalization and has not been negotiated at arm's length;
- enables securities to be sold at prices lower than permitted under the TSX pricing rules; or
- involves the issuance of more than 25% of the company's outstanding listed securities (on a non-diluted basis) before the date of closing where the price per security is less than market price.

Where shareholder approval is required, that approval must be obtained from a majority of holders of the company's securities at a duly called meeting. A meeting may be avoided if the company provides the TSX with written evidence that holders of more than 50% of the company's securities are familiar with the terms of the proposed PIPE and are in favour of such transaction.

The TSX Venture Exchange (the TSX-V) imposes similar rules and obligations in respect of PIPE transactions for companies listed on the TSX-V. There are, however, some notable differences between the TSX-V and the TSX in their regulation of the terms of a PIPE. The TSX-V, for example, does not permit the price per share to be lower than the maximum discount of the market price, whereas the TSX may permit a greater discount where shareholder approval is obtained.

Securities

The type and terms of securities to be issued to the investor by the company as part of a PIPE transaction are typically negotiated on a deal-by-deal basis, but often involve the issuance of common or preferred equity, convertible securities, warrants or other equity-linked securities. Generally, a company will prefer to issue common equity, while an investor may want preferred or convertible equity to ensure an additional level of investor protection and priority over the company's other shareholders.

Pricing rules

The TSX and TSX-V rules provide for the following limits on the discount that may be offered on securities issued in a PIPE:

Market Price	Maximum Discount
Up to \$0.50	25%
\$0.51 to \$2.00	20%
Above \$2.00	15%

The TSX and TSX-V also have specific requirements in respect of the issuance of convertible securities.

The transaction must generally close within a specified period of time. For securities to be listed on the TSX, the transaction must close within 45 days of the date on which the market price of the securities being issued is established (or, if a shareholder meeting is required, 135 days). For securities to be listed on the TSX-V, the transaction must close within 30 days of the date the company reserves the proposed offering price. The applicable exchange may approve an extension on a case-by-case basis to align with a longer regulatory timeline or a concurrent transaction.

Investor insider reporting obligations

A PIPE transaction may result in an investor becoming subject to restrictions and ongoing compliance obligations under Canadian securities laws. The nature and extent of these restrictions and obligations will be a function of the investor's percentage security holdings.

- If an investor acquires voting or equity securities of a company that result in the investor owning 10% or more of the outstanding voting or equity securities of the company, the investor will be subject to "early warning" requirements under applicable securities laws. These requirements include issuing a news release and filing a public report, a one-business-day moratorium on further acquisitions and further reporting upon (i) acquisitions and dispositions of 2% of voting or equity securities; (ii) falling below the 10% ownership threshold; or (iii) any change in a material fact contained in the report. Certain eligible institutional investors may be able to avail themselves of the more lenient alternative monthly reporting regime. Investors will also become subject to insider reporting requirements at this threshold.
- If an investor acquires voting or equity securities of a company that results in the investor owning 20% or more of the outstanding voting or equity securities of the company, future (i) dispositions of securities by the investor must be made pursuant to a prospectus or a prospectus exemption; and (ii) acquisitions of securities by the investor may trigger the requirements of the Canadian take-over bid regime in the absence of a take-over bid exemption.



Investor rights and company protections

Investor rights and company protections tend to be the most extensively negotiated aspects of a PIPE transaction. While they can vary considerably from deal to deal, certain common rights and protections we see when negotiating PIPE transactions are summarized below.

For private equity investors, an important aspect of investing involves securing strategic oversight of portfolio companies. PIPEs generally do not provide an investor with the same degree of control over the company as would be typical in a pure private equity buy-out transaction. While an investor may gain some influence over corporate decisions, public companies may resist granting the investor approval rights over key business decisions or fundamental changes to the organization; there are few examples where approval rights have been given. As a result, there may be an underlying tension between traditional private equity and PIPEs, depending on an investor's typical investments and strategy.

Investor rights

Investors may request certain types of rights to safeguard and monitor their investment.

Registration rights

The investor may have the right to require the company to file a prospectus to qualify the securities issued under the private placement for resale, typically pursuant to a registration and qualification rights agreement (registration rights). Registration rights may include, or be limited to, "piggyback" rights to participate in an offering being conducted by the company, but without the ability to "demand" a registration. Principal areas of negotiation will include

(i) the threshold at which the registration rights fall away; (ii) the number of times that registration rights may be exercised; (iii) postponement rights for the company in certain circumstances; (iv) who bears the costs associated with any registration or qualification; and (v) indemnification obligations.

Information rights

The investor may have the right to receive certain information over and above regular public company disclosure required to be made to shareholders. Information rights may include the right to review monthly financial statements and to be provided advance notice of certain transactions.

Pre-emptive rights

Pre-emptive rights are a preferential right to (i) provide future financing; (ii) acquire a proportionate share of any securities issued as part of future financings; and/or (iii) maintain an investor's proportionate equity interest in the company. These rights may be subject to limitations; for example, a company may not have to comply if any actions taken in connection with this right would require seeking shareholder approval.

Board nomination rights

Board nomination rights provide the investor the right to require the company to nominate one or more directors to the board of the company. Nomination rights are often proportionate to the investor's interest, and may terminate if the investor disposes of a certain percentage of securities it acquired from the company pursuant to the PIPE transaction or if the investor's ownership in the company drops below a certain threshold. Nomination rights may include the right for the board nominee to sit on all, or a subset of, board committees. Where nomination rights are unavailable, an investor may instead negotiate for the right to appoint an observer to the board and its committees. When negotiating director nomination rights, investors should keep in mind that all directors, including nominee directors, will be subject to shareholder approval and owe fiduciary duties to the company (and not to the investor specifically).

Redemption rights

Redemption rights are the right of the investor to require the company to repurchase the investor's securities in certain circumstances, including if the company sells all or substantially all of its assets, becomes de-listed from the stock exchange on which its securities are listed or engages in a fundamental change (including a change of control). Contractual redemption rights are challenging in light of the securities law requirements for issuer bids, though redemption or retraction rights may be included in the terms of a particular class of securities.

Veto rights

The investor may have the right to veto significant actions or important decisions of the company regarding its business, including (i) fundamental changes, such as amending the company's articles and/or bylaws; (ii) issuing new classes of securities ranking in priority to the class of security issued as part of the PIPE transaction; (iii) incurring additional indebtedness in excess of prescribed thresholds; or (iv) making substantive changes to the company's business plan or operations.

Company protections

Companies may also require certain protections in connection with a PIPE.

Transfer/resale restrictions

A company may negotiate for a mandatory post-closing hold period that is beyond the four-month statutory period (typically varying from one to three years) or other restrictions on the investor's ability to transfer its securities. Other restrictions that may be negotiated include limitations on how resales may be made (for example, restricting resales to broadly marketed distributions or prohibiting resales to customers, competitors or other significant shareholders of the company). Alternatively, a company may seek an opportunity to "place" the securities in the hands of a supportive shareholder before the investor is able to sell them.

Standstill

A company may be able to negotiate for an investor standstill for either a fixed period of time or for so long as the investor owns a minimum percentage of the company's securities. During the standstill, the investor will agree not to acquire any additional securities of the company or to engage in actions that the company's board of directors considers hostile, which may include proxy contests that involve replacing the directors and unsolicited take-over bids.

Voting support

A company may seek a commitment from the investor to vote as directed by the company for a fixed period of time. If the investor agrees, these provisions typically exclude special business, such as a potential sale transaction.



Conclusion

PIPE transactions offer many benefits to investors and companies alike, providing a mechanism for public companies to access private capital pools and for investors to deploy capital relatively quickly into public markets on flexible terms. Given the bespoke nature of these transactions, financial and legal advice is critical to help the parties navigate these deal dynamics effectively.

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Osler's industry-leading Corporate group advises Canadian and international clients on the complex and strategic transactions integral to the success of their business. Our team has the expertise, experience and connections to help companies and investors access and deploy new sources of capital, through traditional financing methods, tailored PIPE transactions and other creative approaches. Leveraging our collaborative one-firm approach, we assist clients in structuring and executing investment strategies through each stage and aspect of the investment cycle. For more information about how our Corporate group can help your business, visit osler.com.

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