Legal Year in Review

Osler’s insights on key developments in 2016 and their implications for Canadian business.
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Introduction

As 2016 comes to a close, it is time again to share with our clients and friends our observations about what we believe to be some of the most significant legal developments affecting Canadian business over the past year and their implications for 2017 and beyond.

Climate change regulation has moved to the forefront for governments facing mounting pressure to meet the commitments made at the UN Climate Change Conference in Paris in December 2015. The Ontario, Alberta, Quebec, and most recently, the Nova Scotia governments have adopted a range of different policy solutions – such as carbon taxes or cap-and-trade programs – for reducing greenhouse gas emissions. Meanwhile, the federal government began positioning Canada as a global leader on climate change by introducing a national carbon pricing floor in late 2016. Greenhouse gas emitters will clearly have to grapple with the challenges of conducting business on an economically viable basis while complying with these new regulatory requirements. At the same time, there is potential for significant innovation and opportunity for market participants in areas of green energy and energy conservation.

Prior to 2016, few people had heard the term “FinTech” or had any idea of what it meant. At one end of the FinTech spectrum are traditional software companies providing technologies specifically designed for financial institutions. At the other end are potentially “disruptive” technology-enabled financial services companies that make it easier for consumers to bypass traditional bricks-and-mortar financial institutions in engaging in financial transactions or acquiring financial services. Today, emerging FinTech companies are achieving unprecedented success in raising capital and the Canadian government is announcing plans to encourage innovation in financial services like never before. The FinTech opportunity also raises a challenge: how best to regulate this nascent industry and to balance the interests of new entrants and established players.

There were a number of significant developments in Canadian corporate and securities law in 2016. These encompassed regulatory amendments, such as the adoption of the new Canadian take-over bid regime and the revised early warning rules. As well, several significant decisions were released by courts and securities regulatory tribunals, including (most notably) the InterOil decision from the Yukon Court of Appeal. The Court’s decision to block Exxon Mobil’s proposed
US$2.3 billion acquisition of InterOil Corporation, despite the fact that it was approved by over 80% of the votes cast by InterOil’s shareholders, may have significant implications for the future conduct of public company acquisitions.

While 2016 was a year of political turmoil in the United States, the U.S. Securities and Exchange Commission (SEC) worked on ongoing initiatives, with developments that are more evolutionary than revolutionary. Of particular interest to Canadian companies and Canadian investors active in U.S. markets is a requirement for mining and oil and gas companies to disclose payments made to foreign governments relating to commercial development. Additionally, the SEC has proposed to shorten the standard securities trade settlement cycle by one business day to reduce risk during the period between trade and settlement. Finally, the SEC’s proposed adoption of universal proxies could influence future similar developments in Canada.

The corporate governance landscape in Canada continued to evolve on a number of fronts. Diversity disclosure practices were under the microscope following the first full year of mandated disclosure under securities laws regarding the representation of women on boards and in executive officer positions. Initiatives in this area were also announced by the Ontario and federal governments. The Toronto Stock Exchange proposed corporate governance and security-based compensation website disclosure requirements. Proposals by the federal government to change the rules for director elections under the Canada Business Corporations Act (CBCA) are a potential cause for concern. Further shareholder engagement initiatives, including recommended amendments to the shareholder proposal provisions of the Business Corporations Act (Ontario) and proposed amendments to the CBCA to allow electronic delivery of proxies, are in process.

Contested regulatory enforcement cases in Canada were overshadowed by a number of record-setting “no-contest” settlements that topped the unprecedented settlements seen in 2015. Although there were few cases of note on the regulatory front, a number of jurisdictions gave themselves new tools to employ in their battle against capital market abuses. For example, the OSC became the first regulator in Canada to introduce a “bounty-based” whistleblower policy. This policy has been hailed by the OSC as a “game changer” and an important means through which to obtain crucial evidence needed to pursue a number of complex securities violations, such as insider trading, market manipulation, and sophisticated fraud. On the other hand, companies will want to ensure that zealous whistleblowers do not foreclose their ability to enter into no-contest settlements with the OSC.

In 2016, plaintiffs continued to try to circumvent the protections – such as the requirement to obtain leave to commence a proceeding and the cap on damages – that are offered to defendants under the Securities Act (Ontario) in relation to secondary market claims. Other creative plaintiffs sought unsuccessfully to characterize primary market claims against underwriters as secondary market claims in order to increase potential liability. These attempts were largely unsuccessful. Market participants should continue to be confident that Ontario Courts are prepared to uphold the hard-won protections under the secondary
market provisions of the *Securities Act*, and to recognize the difference between primary and secondary market claims. At the same time, market participants should be prepared to fend off similar creative approaches in future.

Aboriginal issues and the duty to consult continue to be among the primary risks to resource development in Canada. While the basic legal principles that govern Aboriginal consultation in Canada are well established, consultation requirements for both project proponents and the Crown can be elusive in practice and execution. This was highlighted in the recent Federal Court of Appeal decision in *Gitxaala Nation v. Canada*, which overturned the federal government’s approval of Enbridge’s Northern Gateway Project – a multi-billion dollar pipeline system proposed to run from Edmonton, Alberta, to Kitimat, British Columbia. Just prior to the time of writing, the federal government announced that the Northern Gateway Project has been rejected. Even though *Gitxaala* represents a loss for the Northern Gateway Project and its proponent, it provides helpful clarity in relation to the duty to consult that may allow future projects to avoid a similar outcome.

In response to mounting public concern over tax avoidance and evasion, the federal government in Budget 2016 announced the dedication of an additional $444.4 million to the Canada Revenue Agency (CRA) over the next five years to combat these issues. In light of public scrutiny, it is not surprising that 2016 has seen the CRA increase the number and scope of its audits, take aggressive positions under the general anti-avoidance rule and the transfer pricing rules, and impose penalties at unprecedented levels. We expect this environment of heightened audit and assessment activity to persist in the near term. Businesses should closely examine tax risk management practices, monitor key legal developments and adjust tax planning accordingly, as well as ensure that appropriate processes are in place to prepare for increased audit scrutiny.

Private equity continues to attract significant amounts of capital. According to Preqin’s “2016 Preqin Global Private Equity & Venture Capital Report”, the global amount of “dry powder” has now topped US$1.3 trillion, the highest since the data provider’s records began in 2000. One noteworthy trend is the elevated appetite for direct investments by limited partners in private equity and venture capital deals. In 2015, limited partners were involved in 168 completed deals, a 23% rise from 2012. This appetite for direct investing can be troubling for the general partners of private equity funds who have historically relied – and continue to rely – on investments in their funds from institutional investors such as sovereign-wealth funds and pension plans. Given that the appetite and capacity for direct investing seems unlikely to diminish in the near future, co-investment rights on reasonable terms provide a solution for general partners seeking to ensure the continued availability of flexible and committed capital.

The oil and gas industry continues to suffer through a downturn, leading to a number of restructurings. Corporations in financial difficulty are increasingly turning to the arrangement provisions of the CBCA or equivalent provincial corporate statutes to restructure corporate bonds and similar debt obligations at a lower cost and on an accelerated timetable relative to more traditional insolvency proceedings. CBCA arrangements have proven to be an effective and flexible alternative for restructuring or recapitalizing certain debt obligations and making other fundamental changes to a corporation’s capital structure.
without a formal admission of insolvency. A successful CBCA arrangement proceeding has fewer repercussions for a corporation’s business and its reputation than a traditional insolvency filing.

Last year we noted the wave of special purpose acquisition corporation (SPAC) offerings. The deadlines for completing qualifying acquisitions – namely, an acquisition by the SPAC of a business using the escrowed proceeds of the initial equity offering – is fast approaching, and four proposed transactions have been announced. Whether these qualifying acquisitions can be completed will likely determine the viability of this acquisition structure going forward.

As we monitor these and other legal developments in 2017, we would be happy to discuss them with you.
Climate change law moves into high gear

Climate change regulation has moved to the forefront of policy and regulatory issues facing governments as pressure mounts for global leaders to meet the commitments made at the UN Climate Change Conference in Paris in December 2015. Canada’s provincial governments have adopted a range of different policies to reduce greenhouse gas emissions, while the federal government began taking steps to position Canada as a global leader on climate change by signing the Paris Agreement and introducing a national carbon pricing floor in late 2016. At the provincial level, Ontario unveiled its new cap-and-trade program. The Alberta government made significant policy changes in 2016 to implement its aggressive Climate Change Leadership Plan to clean up the province’s carbon reputation. Québec put forth its new 2030 Energy Policy, Nova Scotia announced it would implement a cap-and-trade system by 2018, and British Columbia continued with its carbon tax initiative.

As there are a variety of approaches to carbon management in Canada, including cap-and-trade, carbon taxes and direct regulatory measures, large greenhouse gas emitters will be challenged to find the most efficient and cost-effective ways to comply with the diverse and still-evolving regulations. For some, these regulations also present significant opportunities – for example, in the form of market- or government-supported development of renewable power facilities, cogeneration facilities and operational efficiency measures.
NATIONAL CARBON PRICING

One of the main challenges of the implementation of a national climate change policy is that the provincially led climate change initiatives implemented to date represent differing solutions to this issue. For example, British Columbia has adopted and Alberta is about to implement a carbon tax to curb greenhouse gas emissions, while Ontario, Québec, and eventually Nova Scotia, are or will be operating under a cap-and-trade model.

In late 2016, the federal government signed the Paris Agreement, committing to reducing Canada’s greenhouse gas emissions by 30% below 2005 levels by 2030, and announced its national carbon price program, which will require all Canadian jurisdictions to have carbon pricing in effect by 2018. The provinces and territories will remain free to choose whether to implement a carbon tax or a cap-and-trade system, as long as they meet the minimum federal pricing and emissions reduction targets. For jurisdictions that do not implement a carbon tax or cap-and-trade system by 2018, or that do not meet the federal pricing and emission reduction minimums, the federal government will impose a mandatory pricing system. Current proposed guidelines require carbon pricing to start at a minimum of $10 per tonne in 2018 and rise by $10 a year to reach $50 per tonne in 2022.

No details have yet been released with regard to how the national carbon price will be implemented and how the program will account for the fundamentally different nature of cap-and-trade and carbon tax models. In addition, the program may have to withstand judicial scrutiny, as Saskatchewan has announced that it is considering a constitutional challenge on the basis that the federal legislation is really a tax that cannot be imposed on Saskatchewan’s Crown corporations (such as SaskPower and SaskEnergy) because governments cannot tax one another. Further details regarding the national program are expected to be released in the new year.

THE ONTARIO CAP-AND-TRADE REGIME

In February 2016, the Ontario government unveiled the Climate Change Mitigation and Low-carbon Economy Act. The Act establishes the foundations for a cap-and-trade system in Ontario.

The cap-and-trade program introduces a limit (i.e., “cap”) on how many tonnes of greenhouse gas pollution are allowed to be emitted in the province. This limit is lowered annually in order to achieve the greenhouse gas reduction targets set out in the Act. Certain entities, particularly those that are in trade-exposed, emissions-intensive industries, are issued an allotment of free allowances. If any participant’s greenhouse gas emissions exceed its free allowance, or if a participant does not have a free allowance, it must procure allowances to cover all its emissions. To that end, entities can buy or sell allowances (i.e., “trade”). If an entity has reduced its emissions below its free allowances, it can trade its excess allowances to an entity that requires further credits. Emissions credits can also be purchased during quarterly government auctions – with proceeds being invested by the government in projects that reduce greenhouse gas pollution.
Facilities that generate greenhouse gas emissions of 25,000 tonnes or more, fuel suppliers that sell more than 200 litres of fuel per year and electricity importers or electricity generators that are directly connected to a gas transmission system are required to register under the program by November 30, 2016. Facilities generating more than 10,000 but less than 25,000 tonnes of greenhouse gas emissions may opt to participate.

Entities that do not have emissions to report can choose to participate in the allowance auctioning system. These market participants will typically be individuals, not-for-profit organizations and companies without compliance obligations.

The Ontario government anticipates that 82% of Ontario’s current greenhouse gas emissions will be captured by the cap-and-trade program. The government also estimates that the auction process will generate $1.9 billion annually which will be reinvested into initiatives to reduce Ontario’s overall greenhouse gas emissions and facilitate the transition to a low-carbon economy. The cap-and-trade regime is slated to come into effect on January 1, 2017.

ALBERTA CLIMATE CHANGE LEADERSHIP PLAN

In 2016, the Alberta government introduced significant policy changes to implement the Climate Change Leadership Plan announced by Premier Rachel Notley in November 2015, including (1) a legislated phase-out of coal electricity production, to be replaced by renewable electricity production; (2) an economy-wide price on carbon emissions; (3) a cap on the annual carbon emissions from oil sands production; and (4) a methane reduction strategy. The Alberta government also endorsed the Alberta Electric System Operator’s (AESO) recommendations for the Renewable Electricity Program (the REP), a competitive procurement process to select certain renewable energy projects to qualify for limited government incentives.

1. REPLACEMENT OF COAL WITH RENEWABLE ENERGY PRODUCTION

The phase-out of coal as a power source and the increase in electricity production from renewable sources present both significant opportunities and challenges for the power industry.

On November 3, 2016, the Alberta government introduced the Renewable Electricity Act, which sets a goal of producing 30% of the total electricity generated annually in Alberta from renewable energy resources by 2030, and announced the first competition under the REP. The Alberta government intends to add 5,000 megawatts of renewable electricity capacity by 2030 through the REP, a competitive procurement process to be administered by the AESO, with the first 400 megawatts of renewable electricity capacity to be procured through a competitive RFP in 2017 and subsequent tranches of capacity to be contracted to coincide with the retirement of coal power plants.
On November 10, 2016, the AESO released a summary of the proposed key provisions of the Renewable Energy Support Agreement (RESA) to be entered into by the AESO and each successful bidder. RESAs will take the form of a “contract for difference” for a 20-year period starting from the commercial operation of the relevant facility – if the bid price exceeds the Alberta power pool price, the AESO pays the successful bidder the difference, and if the bid price is less than the Alberta power pool price, then the bidder pays the difference to the AESO.

On November 24, 2016, the Alberta government announced that it reached an agreement with Capital Power Corp., TransAlta Corp. and ATCO Ltd. to pay them a total of $1.36 billion, as annual payments of $97 million per year from 2017 to 2030. These payments represent compensation for the early shut down of six of the 18 coal-fired plants in the province which were expected to operate past 2030. The other 12 coal-fired plants in Alberta are scheduled to close or convert to natural gas before 2030.

2. CARBON LEVY

On May 24, 2016, Bill 20: the *Climate Leadership Implementation Act* was introduced, which proposed two new statutes: the *Climate Leadership Act*, which establishes the carbon levy on Albertans and Alberta businesses, and the *Energy Efficiency Alberta Act*, which establishes a Crown corporation with the mandate to design and deliver renewable energy and energy conservation systems.

The *Climate Leadership Act* imposes a carbon levy on consumers of all carbon-emitting fuels throughout the fuel supply chain of $20 per tonne beginning in January 2017, with an increase to $30 per tonne in January 2018. The carbon price is expected to affect 78-90% of all emissions in the province, the largest proportion in all of Canada. Under the Act, revenues generated through the carbon levy may only be used to (a) fund initiatives to reduce greenhouse gas emissions; (b) support Alberta’s ability to adapt to climate change; and (c) provide carbon levy rebates or adjustments to consumers, businesses and communities.

3. CAP ON OIL SANDS EMISSIONS

On November 1, 2016, the Alberta government introduced the *Oil Sands Emissions Limits Act*, which imposes a limit on oil sands greenhouse gas emissions to an annual maximum of 100 megatonnes, with allowances for new upgrading and cogeneration. This limit will apply to in-situ sites, mine sites, processing plants, and primary production, enhanced recovery and experimental schemes as well as buildings, equipment, structures and vehicles associated with those sites. The Act will take effect when passed in the legislature and proclaimed in force but will not obligate oil sands producers until a regulatory system is designed and implemented.
4. METHANE REDUCTION PROGRAM
The methane reduction strategy seeks to reduce methane emissions from oil and gas operations by 45% by 2025 through (1) applying new emissions design standards to new Alberta facilities; (2) improving measurement and reporting of methane emissions as well as leak detection and repair requirements; and (3) developing a joint initiative on methane reduction and verification for existing facilities, and backstopping this with regulated standards that take effect in 2020, to ensure the 2025 target is met. The Alberta government has committed more than $70 million to pursue its methane reduction target and to fund methane emission reduction technology development. Proposed methane reduction projects will be selected through a competitive process and be eligible for funding up to a maximum of $5 million.

THE QUÉBEC 2030 ENERGY POLICY
In April 2016, the Québec government announced its 2030 Energy Policy, which sets very ambitious targets – elimination of the use of thermal coal, reduction of the amount of petroleum products consumed by 40% and a reduction of greenhouse gas levels by 37.5% over 1990 levels.

The 2030 Energy Policy has four primary objectives: (1) the decarbonization of Québec, (2) the reduction of energy consumption and improvement of production efficiency, (3) the continued responsible use of Québec’s natural resources, and (4) the innovation and development of Québec’s green economy.

Details on how these objectives and the ensuing targets will be achieved are still being debated. However, it is clear that Québec’s existing cap-and-trade program will play a large role. Unlike prior policy initiatives, the 2030 Energy Policy’s impact will not be limited to Québec’s energy sector.

NOVA SCOTIA’S PROPOSED CAP-AND-TRADE REGIME
On November 21, 2016 the government of Nova Scotia and the federal government jointly announced that Nova Scotia will implement a cap-and-trade regime, which will come into force in 2018. Nova Scotia will set a province-wide target that meets or exceeds Canada’s target of reducing emissions by 30%, from 2005 levels, by 2030. The government of Nova Scotia and the federal government have also come to an agreement in principle that will allow the province to keep its coal-fired electricity plants open beyond the 2030 federal deadline. Part of the agreement stipulates that Nova Scotia will be required to achieve deeper emission reduction targets elsewhere in order to meet the equivalent of closing all coal plants by 2030. There is no current deadline establishing when Nova Scotia’s remaining coal plants will be required to shut down.
CONCLUSION

There are both significant opportunities and challenges presented by the various climate change regulations being introduced across Canada. The unprecedented level of investment by government in carbon emissions-reducing solutions, including renewable energy, reduced dependence on coal and increased energy efficiency, will provide new development and investment opportunities. On the other side of the ledger, new taxes and levies associated with carbon regulation will require carbon or energy intensive businesses to devise strategies to minimize overall compliance costs while remaining competitive. As the carbon regulation landscape continues to evolve across the country, businesses will need to remain apprised of new developments in order to capitalize on the opportunities and mitigate the potential costs.
Prior to 2016, few people had heard the term “FinTech” or had any idea of what it meant. Today, FinTech is attracting headlines in major media outlets. Emerging FinTech companies are achieving unprecedented success in raising capital and the Canadian government is announcing plans to encourage innovation in financial services like never before. There is significant excitement about the promise of FinTech to revolutionize financial services in Canada and globally. Carolyn Wilkins, the Senior Deputy Governor of the Bank of Canada, recently proclaimed: “It is no exaggeration to say that we are in the midst of a defining moment for innovation in financial services.”

CANADIAN FINTECH AT A GLANCE

FinTech encompasses a wide range of companies, from traditional enterprise software companies providing technologies specifically designed for financial institutions to technology-enabled financial services companies that use technology to make it easier to apply for a loan, send money, get investment advice, buy goods, raise capital or engage in secure transactions using a distributed ledger. In the case of technology-enabled services, there is significant potential for FinTech to disrupt the traditional methods by which financial services are distributed and consumed in Canada. Established or ‘traditional’ bricks and mortar financial institutions in Canada have signalled that they intend to strongly embrace FinTech to deliver value to customers, improve efficiency and fend off new competitors, while emerging companies are aggressively courting the customers of those institutions with services that emphasize the user experience, convenience and low cost.
Lending

In the lending space, Canada has seen significant growth in emerging FinTech companies that operate online lending businesses for consumers (e.g., Borrowell, Mogo, Progressa) and small business (e.g., Thinking Capital, FundThrough). There is no requirement to be a licensed bank to lend money in Canada and therefore emerging FinTech companies present direct competition to Canadian banks with significantly lighter regulatory burdens (some provinces have licensing requirements for non-bank lenders and all provinces regulate the disclosures made by lenders to consumers). However, some Canadian banks have recently announced partnerships with FinTech lenders; for example, CIBC partners with both Borrowell and Thinking Capital to offer more lending options and speedier loan approvals to its consumer and business customers.

Online advice

The explosive growth of automated, online investment advisory services (referred to as online advisers or robo advisers) was one of the earliest examples of FinTech going mainstream. Canada has a number of online advisers operated by both emerging FinTech companies (e.g. Wealthsimple, Wealthbar) and established financial institutions (e.g. BMO SmartFolio, Questrade). Unlike the online lending space, online adviser partnerships between emerging FinTech companies and banks are rare. Online advisers must be registered with provincial securities regulators and comply with the same requirements that apply to traditional portfolio managers.

Insurance

All aspects of the insurance business are heavily regulated in Canada – from underwriting to distribution to claims adjustment. As a result, FinTech has had a smaller impact on the Canadian insurance industry. But FinTech can bring novel data analytical tools and digital platforms to the insurance business and we expect significant change in the future as established insurance companies embrace new technologies and in some cases partner with emerging companies (e.g. Zensurance, League).

Enterprise software and other platforms

The examples above are just the tip of the Canadian FinTech iceberg. There is a wide range of emerging Canadian companies that offer FinTech solutions to consumers, to established financial institutions or to consumers through established financial institutions. Consider the example of Sensibill – Bank of Nova Scotia recently launched Sensibill’s innovative digital receipt technology through their online banking platform and mobile banking app and a number of other banks in Canada and globally are piloting the technology for launch in the near future. Other examples can be found with online payments (e.g. Paycase, Plooto), loyalty programs (e.g. Drop Loyalty), alternative banking platforms (e.g. Clearbanc), financial due diligence solutions (e.g. OutsideIQ), fraud detection (e.g. Verafin), investor relations and market intelligence (e.g. Q4) and loan portfolio management (e.g. Aspire).
EXISTING REGULATORY FRAMEWORK

Given the relatively recent attention of elected officials and regulators to FinTech in the Canadian market, it is perhaps not surprising that there is no special regulator (or regulations) targeted specifically at FinTech companies. This does not mean that FinTech companies are not subject to any regulations – on the contrary, they are subject to the same regulations that the bricks-and-mortar companies would be subject to if they were providing the same services (with the exception of regulated financial institutions who are subject to several additional regulations). Such regulations often include both licensing (for example, securities dealer, mortgage broker or insurance) and ongoing compliance requirements.

This “same application” of regulations – although fair at one level – creates potential compliance issues for FinTech companies that either do not have the funds to fully comply with all the regulations or, because of the virtual nature of their business model, do not fit neatly into the existing regulatory compliance framework. Both the federal and provincial governments in Canada appear to be aware of this issue. In August 2016, the Canadian federal government published a Consultation Paper soliciting feedback from stakeholders on the future of the financial sector. The consultation paper acknowledges the growing importance of FinTech companies and focuses specifically on how the financial sector framework should support innovation and competition, particularly from new entrants, while maintaining stability and consumer protection.

At the provincial level, the Ontario Securities Commission (OSC) recently announced the formation of OSC Launchpad. OSC LaunchPad is designed to engage with FinTech companies, supports FinTech companies in navigating the regulatory requirements and aims to keep securities regulation in step with digital innovation. Although nascent, OSC Launchpad played a significant role in developing an exemption from certain Ontario securities laws for AngelList, a digital platform that enables syndicates of angel investors to invest in emerging companies. This is one of the first of what we expect to be many examples of Canadian regulators developing temporary and tailored exemptions to regulatory requirements in order to enable FinTech companies to test new services in the Canadian market, without comprehensive adherence to all the financial services regulations that would otherwise apply. In addition to OSC LaunchPad, both the OSC and the Quebec Autorité des marchés financiers (AMF) have announced FinTech working groups with mandates that include analyzing technological innovations in the financial sector in order to anticipate regulatory and investor protection issues. Also, the OSC and the Australian Securities and Investment Commission (ASIC) recently announced an agreement to support innovative businesses in their respective jurisdictions and the OSC hosted a FinTech hackathon called #RegHackTO.
FUTURE DEVELOPMENTS

FinTech is still in its early stages in Canada, and for now might look more like an evolution than a revolution. However, the pace of change is gaining momentum and will likely accelerate in the year to come. We expect that the Canadian federal government and provincial governments will continue to embrace Canadian FinTech initiatives through industry outreach, rule changes and support of organizations such as MaRS that act as technology incubators and accelerators. For emerging FinTech companies, there are significant opportunities to disrupt the Canadian financial services industry, but careful consideration of the existing regulatory framework and dialogue with regulators is necessary. For established financial institutions, the opportunities to use FinTech are equally significant, while the lessons from other industries of the consequences of failing to embrace technology are stark.

Editor’s Note: Borrowell, FundThrough, Progressa, Wealthsimple, Sensibill, Paycase, Plooto, Drop Loyalty, OutsideIQ, Verafin, Zensurance, Q4, Clearbanc and Aspire are Osler clients.

AUTHORS

Chad Bayne
Partner, Corporate
cbayne@osler.com
416.862.4708

Kashif Zaman
Partner, Financial Services
kzaman@osler.com
416.862.6804

Blair Wiley
Partner, Corporate
bwiley@osler.com
416.862.5989
Key Canadian corporate and securities law developments

There were a number of significant developments in corporate and securities law in 2016, as a result of both regulatory amendments and proposals and several significant decisions from courts and securities regulatory tribunals. Take-over bids continued to occupy a prominent place in the national spotlight. The debates of prior years regarding the appropriate framework for take-over bids were concluded when the long-anticipated new take-over bid regime came into force – likely the single most important development of the year. The new bid regime significantly lengthens the timeframe for hostile take-over bids in Canada as well as introducing a mandatory majority tender condition that effectively eliminates “any and all” bids. The first hostile bid launched following the introduction of the new regime resulted in the high profile Dolly Varden decision of the Ontario and British Columbia Securities Commissions regarding the application of National Policy 62-202 – Defensive Tactics. Other significant developments included revisions to the early warning system, as well as the InterOil decision from the Yukon Court of Appeal, which has potentially significant implications for the conduct of friendly public company acquisitions in Canada.

Here is our list of the year’s most notable developments, grouped by: (1) changes in securities law and regulation, (2) changes in corporate law and stock exchange rules, and (3) court and securities regulatory decisions in the corporate and securities law areas.
CHANGES IN SECURITIES LAW AND REGULATION

1. New take-over bid and early warning rules finally come into force

On May 9, 2016, the new Canadian take-over bid regime came into force, representing the most significant change to take-over bid practice since 2001 and finally bringing uniformity to the take-over bid rules across all Canadian jurisdictions. Take-over bids must now remain open for 105 days unless the target’s board agrees to a shorter period (of not less than 35 days) or the target enters into an alternative transaction. All bids are now subject to a mandatory minimum tender requirement of more than 50% of the outstanding securities not already held by the bidder or its joint actors and a requirement for a mandatory 10-day extension if the bidder takes up securities under the bid.

The new bid rules are likely to narrow the use of shareholder rights plans (poison pills) to protecting against “creeping bids,” such as bids made through the normal course purchase and private agreement exemptions. While the new bid rules were anticipated to reduce the number of hostile bids, it is not yet clear whether they will have that effect. There have been four unsolicited bids launched in the seven months since the new bid rules came into effect, as compared to six unsolicited bids for all of 2015.

At the same time, the Canadian Securities Administrators also adopted revisions to the early warning system to require disclosure when a security holder’s ownership decreases by 2% or more or falls below the 10% reporting threshold and to make the alternative monthly reporting system unavailable to eligible institutional investors that solicit proxies in certain circumstances. Notably, the early warning reporting rules were not revised to adopt two earlier published proposals that had been the subject of considerable debate: a reduced 5% threshold (consistent with the U.S.) and required disclosure covering equity-equivalent derivatives.

(For more information, please refer to our Osler Update entitled “Amendments to Canadian take-over bid and early warning regimes now in force” on osler.com.)

2. Enhanced trade reporting requirements for private placements

In 2016, the Canadian Securities Administrators adopted amendments to the exempt distribution trade reporting requirements to harmonize the trade reporting regime across Canada. Although harmonization has made the form easier to complete across multiple Canadian jurisdictions, the new reporting form does require significantly more information about the issuer and the purchasers, and in some respects significantly increases the compliance burden for certain kinds of offerings.

(For more information, please refer to our Osler Update entitled “New Canadian reporting requirements for Canadian private placement sales” on osler.com.)

3. Advancing a regulatory framework for hedge fund offerings

In September 2016, the Canadian Securities Administrators released a proposed framework for offering retail investors access to “alternative funds” (commonly known as hedge funds). The proposal would permit hedge fund managers to offer alternative funds to the retail market through a long-form prospectus offering. The proposal, while focused on alternative funds, also includes provisions...
that will impact other types of mutual funds (namely conventional mutual funds and exchange-traded funds), as well as non-redeemable investment funds. These changes will be made through amendments to the restrictions relating to investments in physical commodities, other investment funds and illiquid assets. 

(For more information, please refer to our Osler Update entitled “Canadian Securities Administrators propose a regulatory framework for offering hedge funds to the public” on osler.com.)

4. Ontario proposes new approach to regulation of distributions outside Ontario

The Ontario Securities Commission has proposed a new rule that would provide Ontario issuers with more certainty about how to comply with Ontario securities laws when they sell securities to investors outside Canada. The new rule would replace a 33-year old Interpretation Note that became a source of confusion and uncertainty as market practices evolved. If the rule is adopted, Ontario issuers will be able to rely on a number of new exemptions that would eliminate the need for a Canadian prospectus in most common cross-border offering situations. However, Ontario issuers will need to file a new post-closing trade report in many cases, including when selling to U.S. investors under Rule 144A as part of a typical Canadian bought deal or marketed offering.

(For more information, please refer to our Osler Update entitled “Proposed OSC Rule 72-503 to modernize framework for distributions of securities outside of Ontario” on osler.com.)

5. Ontario adopts whistleblower protection

In connection with the July 2016 establishment of the Ontario Securities Commission’s new Whistleblower Program, which includes monetary incentives for whistleblowers in Ontario, the Ontario government has approved amendments to the Securities Act (Ontario)1 to provide additional protection to persons who report a potential violation of Ontario securities law or a by-law or other instrument of a self-regulatory organization.

(For more information, please refer to our Osler Update entitled “A review of new whistleblower protections under Ontario’s Securities Act” on osler.com.)

6. The slow creep towards a national securities regulator continues

In November 2016, Kevan Cowan, former President of TSX Markets and the TSX Venture Exchange, was selected by the Board of the Capital Markets Authority Implementation Organization to be the initial Chief Regulator of the future Capital Markets Regulatory Authority (CMRA) as well as the Chief Executive Officer of the Regulatory Division of the CMRA. The appointment of Mr. Cowan represents a further step towards the implementation of the Cooperative Capital Markets Regulatory System. The Capital Markets Authority Implementation Organization also disclosed in 2016 its intention for the CCMRS to be operational in 2018.

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1 The full text of these changes is set out in section 3 of Schedule 26 of Bill 173, Jobs for Today and Tomorrow Act (Budget Measures), 2016.
For more information about the CCMR, please refer to our earlier Osler Updates entitled “Debate Continues Regarding Proposed Cooperative Capital Markets Regulatory System” and “Securities law developments in 2015: Evolutionary not revolutionary” on osler.com)

CHANGES IN CORPORATE LAW AND STOCK EXCHANGE RULES

7. Amendments to Canada Business Corporations Act

In September 2016, the Canadian federal government introduced legislation to amend the Canada Business Corporations Act – the first such amendment in 15 years – following consultations initiated in 2013. The stated objectives of the proposed amendments are, among other things, to: 1) reform the process for electing directors of certain corporations; 2) modernize communications between corporations and their shareholders; and 3) require disclosure of information respecting diversity among directors and senior management.

(For more information, please refer to our Osler Update entitled “Significant corporate governance changes in proposed amendments to the Canada Business Corporations Act” on osler.com.)

8. TSX proposes mandatory website disclosure

The Toronto Stock Exchange (TSX) published proposed amendments to its Company Manual that would introduce mandatory website disclosure requirements for TSX-listed issuers and revise the disclosure requirements for security based compensation arrangements. If implemented, the new rules and related revisions to proxy circular disclosure requirements will necessitate substantial changes to disclosure practices of all issuers listed on the TSX.

(For more information, please refer to our Osler Update entitled “TSX’s proposed website disclosure rules will expand corporate governance and security based compensation disclosure” on osler.com.)

9. TSX addresses acquisition financing transactions

The Toronto Stock Exchange (TSX) published a Staff Notice regarding prospectus offerings, private placements and concurrent acquisitions, which provides guidance as to when the TSX will allow a concurrent equity financing by an issuer to be priced prior to the time at which the issuer publicly discloses a material transaction. In order to price an equity financing on such basis, the issuer and its advisors need to be satisfied that the issuer would not have agreed to the acquisition or other transaction without having a firm commitment for the equity financing at a specific price and offering size, and be prepared to provide an officer’s certificate to that effect.

(For more information, please refer to our Osler Update “TSX provides guidance regarding the pricing of acquisition financing transactions” on osler.com.)
COURT AND SECURITIES REGULATORY DECISIONS

10. InterOil Decision – implications for fairness opinions, disclosure and corporate governance in sale transactions

In a decision with potentially significant implications for current market practice with respect to fairness opinions, disclosure and corporate governance in public company sale transactions, the Yukon Court of Appeal blocked Exxon Mobil’s proposed US$2.3 billion acquisition of InterOil Corporation. Despite the fact that the proposed plan of arrangement transaction was a topping bid approved by over 80% of the votes cast by InterOil’s shareholders and that the InterOil board of directors received a market standard form of fairness opinion from a leading global investment bank, the Court found that the arrangement was not fair and reasonable on the basis of deficient corporate governance and inadequate disclosure. The decision has implications on market practice for fairness opinions, compensation of financial advisors and disclosure in public acquisition transactions.

(For more information, please refer to our Osler Update entitled “InterOil Decision – Implications for Fairness Opinions, Disclosure and Corporate Governance in Sale Transactions” on osler.com.)

11. Private placements as a hostile bid defensive tactic: the Dolly Varden decision

The British Columbia and Ontario Securities Commissions upheld a contested private placement by the target of an unsolicited take-over bid, concluding that there was a legitimate need for the financing and that the private placement had not been implemented as a defensive tactic in response to the bid. The securities commissions provided important guidance on the regulatory analysis and treatment of contested private placements in light of the traditional limitations on defensive tactics set forth in National Policy 62-202. The decision also acknowledges the importance of the fiduciary responsibilities and business judgment of boards of directors in this context and arguably exhibits a degree of deference to that judgment which has not often been seen on the part of Canadian securities regulators.

(For more information, please refer to our Osler Updates entitled “Contested private placements under the new take-over bid regime: the Dolly Varden decision” and “Contested private placements under new take-over bid regime: Securities regulators reject Hecla challenge of Dolly Varden private placement” on osler.com.)

12. Spring loading in insider trading – the AMF weighs In

In August 2016, the Tribunal Administratif des Marchés Financiers (TAMF) rendered a decision in which it concluded, among other things, that “spring loading” is an offence under the Québec Securities Act. In their decision, the TAMF describes spring loading as the issuance of options to management of a reporting issuer while management is in possession of “privileged” information, knowing that the price of the shares will potentially increase considerably when the privileged information is, in the relatively near future, disclosed to the public.

(For more information, please refer to our Osler Update entitled “Insider trading: a first spring loading case in Québec” on osler.com.)
13. OSC narrows private party standing for public interest application hearings

In a March 2016 decision, the Ontario Securities Commission (OSC) determined not to grant standing to The Catalyst Capital Group Inc. (Catalyst) to bring an application before the OSC under its public interest jurisdiction. Catalyst was seeking to oppose the proposed acquisition of Shaw Media Inc. by Corus Entertainment Inc. and sought an order requiring Corus to provide additional disclosure to its shareholders (which would thereby effectively force Corus to delay its special meeting). The decision was the first time that the OSC has formally denied standing to a party in connection with a public interest application and represents a significant narrowing of the scope of private party standing in Ontario.

(For more information, please refer to our Osler Update entitled “Ontario Securities Commission narrows private party standing for public interest applications in contested transactions: The Corus Entertainment decision” on osler.com.)

14. Bankruptcy and Insolvency Act trumps provincial legislation for oil well abandonment: The Redwater Energy Decision

In a 2016 decision, the Alberta Court of Queen’s Bench determined that provisions of the Bankruptcy and Insolvency Act were paramount to obligations under the Alberta Oil and Gas Conservation Act and the Pipeline Act. The decision therefore allowed a Trustee in Bankruptcy to renounce assets (oil wells) it deemed uneconomic, contrary to provincial regulation requiring the receiver and trustee to abandon, reclaim and remediate a debtor’s licensed assets. The decision has far-reaching implications for an industry that has been hammered by low commodity prices, devastating wildfires, and now the prospect of increased levies to fund the efforts of the Orphan Well Association to assume the obligations of bankrupt participants.

(For more information, please refer to our Osler Update entitled “Implications of the Redwater decision – Where does the buck stop?” on osler.com.)

15. The Supreme Court revisits oppression under the CBCA

In the November 2016 decision in Mennillo v. Intramodal inc., the Supreme Court of Canada revisited the oppression remedy under the Canada Business Corporations Act. A majority of the Court found that a failure to observe legal formalities under the CBCA did not in itself constitute oppression.

Mennillo, a shareholder, director and officer of Intermodal, brought a claim for oppression against Intramodal in relation to a dispute regarding the ownership of his shares. Menillo resigned as a director and officer. Taking the position that Menillo had also resigned as shareholder, the lawyer for the corporation filed a declaration to remove Menillo both as a director and as a shareholder and transferred his shares to the other shareholder of the corporation. However, the corporation failed to observe certain formalities regarding the transfer of the shares.
Mennillo claimed that the corporation had wrongfully stripped him of his shares and that the failure to observe the required formalities meant that the shares were still owned by him. At trial, the judge found that Mennillo had expressly indicated that he did not intend to remain a shareholder and therefore, regardless of the failure to respect the required formalities for the transfer, Mennillo had transferred his shares.

The Supreme Court found there was no basis on which to override the trial judge’s factual findings that Mennillo had no reasonable expectation of owning the shares and that the corporation had transferred the shares, albeit imperfectly, in accordance with his intentions. The Court confirmed that a claim for oppression under the CBCA requires the claimant establish two elements: 1) that the claimant’s reasonable expectations were violated, and 2) that the conduct complained of was “oppressive, unfairly prejudicial to or unfairly disregarding” of the claimant’s interests. A mere failure to comply with the formal requirements under the CBCA cannot, in itself, satisfy the these two elements in the absence of evidence that the corporation acted contrary to or frustrated the complainant’s reasonable expectations in a manner that is oppressive or unfair.

**AUTHORS**

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Donald Gilchrist</td>
<td>Partner, Corporate</td>
<td><a href="mailto:dgilchrist@osler.com">dgilchrist@osler.com</a>, 416.862.6334</td>
</tr>
<tr>
<td>James R. Brown</td>
<td>Partner, Corporate</td>
<td><a href="mailto:jbrown@osler.com">jbrown@osler.com</a>, 416.862.6647</td>
</tr>
<tr>
<td>Doug Bryce</td>
<td>Partner, Corporate</td>
<td><a href="mailto:dbryce@osler.com">dbryce@osler.com</a>, 416.862.6455</td>
</tr>
<tr>
<td>Manny Pressman</td>
<td>Partner, Corporate</td>
<td><a href="mailto:epressman@osler.com">epressman@osler.com</a>, 416.862.4903</td>
</tr>
<tr>
<td>Doug Bryce</td>
<td>Partner, Corporate</td>
<td><a href="mailto:dbryce@osler.com">dbryce@osler.com</a>, 416.862.6455</td>
</tr>
<tr>
<td>Manny Pressman</td>
<td>Partner, Corporate</td>
<td><a href="mailto:epressman@osler.com">epressman@osler.com</a>, 416.862.4903</td>
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While 2016 was a year of political turmoil in the United States, the U.S. Securities and Exchange Commission (SEC) kept working on its ongoing initiatives, with developments that are much more evolutionary than revolutionary. Changes that may be of particular interest to Canadian companies and Canadian investors active in U.S. markets include a requirement for mining and oil and gas companies to disclose payments made to foreign governments relating to commercial development as well as the SEC’s proposal to shorten the standard securities trade settlement cycle by one business day. Also, the SEC’s proposed adoption of universal proxies could influence future similar developments in Canada.

Here are some of the highlights:

**RESOURCE EXTRACTION ISSUER GOVERNMENT PAYMENTS**

The SEC adopted rules requiring resource extraction issuers (including mining companies and oil and gas companies) that are subject to SEC reporting obligations to disclose payments made to governments for the commercial development of oil, natural gas or minerals, as required by the Dodd-Frank Act. The final rules were adopted following several years of court battles over the scope of the disclosure the SEC was mandated by the Dodd-Frank Act to require.

The required disclosure must be made annually using the new Form SD no later than 150 days after the issuer’s fiscal year end. Issuers will have to comply with the new rules starting with their fiscal year ending no earlier than September 30, 2018. Reports prepared under Canada’s *Extractive Sector Transparency Measures Act* will be accepted by the SEC to satisfy this requirement.

(For more information, please refer to our Osler Update entitled “U.S. final rules requiring disclosure of payments by resource extraction issuers” on osler.com.)
T+2 SETTLEMENT CYCLE
The SEC has proposed shortening the standard settlement period for securities trades from three business days (T+3) to two business days (T+2). The stated objective is to reduce the risks that can arise during the period between the trade and settlement.

UNIVERSAL PROXY CARDS
The SEC proposed amendments to the U.S. proxy rules that would require parties in a contested election to use universal proxy cards including the names of all nominees for election – namely, both management and dissident nominees. The rule, if adopted, would ensure that shareholders have the ability to vote for their preferred combination of directors, rather than having to select either the full slate of management candidates or the full slate of dissident candidates. The proposed changes could make it easier and less costly for dissident candidates to be elected to corporate boards, potentially creating ripple effects on corporate governance practices and negotiating strategies for activists.

The proposed rule would not have a direct impact on the vast majority of Canadian companies, even if they are also public in the United States, because most Canadian companies qualify as “foreign private issuers” under the SEC’s rules and are therefore not subject to the SEC’s proxy rules. However, a universal proxy has been successfully used in at least one Canadian proxy contest (Pershing Square’s dissident campaign against CP Rail). The Canadian Coalition for Good Governance has previously expressed support for the use of universal proxies, and the close integration of Canadian and U.S. public markets often leads to adoption of similar requirements under Canadian securities laws.

(For more information, please refer to our Osler Update entitled “The SEC’s universal proxy proposal: How it affects Canadian companies and investors” on osler.com.)

DISCLOSURE EFFECTIVENESS
The SEC is undertaking a major review of its disclosure requirements for public companies in an effort to eliminate redundant, overlapping and outdated requirements; achieve timely, material disclosure by companies; and ensure that shareholders have easy access to that information. In 2016, the SEC solicited comments on various aspects of Regulation S-K, the rules governing all disclosure requirements in SEC filings other than financial statements. It is unknown at this time what actual changes could be adopted as a result of this process, or when they might become effective.

SECURITY-BASED SWAPS
The SEC pressed forward with the reforms required by Title VII of the Dodd-Frank Act in relation to security-based swaps. The SEC adopted final rules implementing business conduct standards and chief compliance officer requirements for security-based swap dealers and major security-based swap participants. The SEC also implemented additional rules for trade acknowledgment and verification requirements for security-based swaps, as well as further amendments and guidance related to regulatory reporting and public dissemination of security-based swap transactions, designed to increase transparency.
THE JOBS ACT
The SEC completed all of the rulemaking projects mandated by the JOBS Act. The last set of rules increased the thresholds for mandatory registration requirements under the U.S. Securities Exchange Act of 1934 (the Exchange Act), and implemented related changes to the requirements for termination of registration and suspension of reporting. As a result of the JOBS Act changes, absent an exemption, an issuer that is not a bank, bank holding company or savings and loan holding company is required to register a class of equity securities under the Exchange Act if it has more than US$10 million of total assets and the securities are “held of record” by either 2,000 or more persons, or 500 or more persons who are not accredited investors.

MINING DISCLOSURE
The SEC proposed rules to modernize disclosure requirements for mining properties and replace current Industry Guide 7, which has not been updated for more than 30 years. Among other reforms, the new rules would require disclosure of mineral resources and material exploration results, in addition to mineral reserves, instead of only permitting disclosure of reserves. If adopted, the SEC’s new rules would bring U.S. reserve and resource disclosure requirements more in line with industry and global regulatory practices and standards, particularly those of the Committee for Mineral Reserves International Reporting Standards (CRIRSCO). This would make the U.S. regime more consistent with Canadian National Instrument 43-101.

CROWDFUNDING
The SEC’s new crowdfunding rules came into effect in May. The rules allow smaller U.S.-based companies to raise up to US$1 million in a 12-month period through Internet-based funding portals. Individuals do not have to qualify as accredited investors or meet other eligibility criteria to participate, but the maximum amount an individual can invest each year is tied to his or her annual income and net worth, and cannot exceed US$100,000.

AUTHORS

Jason Comerford
Partner, Corporate
jcomerford@osler.com
212.991.2533

Rob Lando
Partner, Corporate
rlando@osler.com
212.991.2504
Governance in 3D – Diversity, disclosure and director elections

The corporate governance landscape in Canada continued to evolve rapidly on a number of fronts in 2016. Diversity disclosure practices were under the microscope following the first full year of mandated disclosure under securities laws regarding the representation of women on boards and in executive officer positions. Initiatives in this area were also announced by the Ontario and federal governments. The Ontario Securities Commission (OSC) established a program to provide financial rewards to whistleblowers who disclose potential wrongdoing, while the Toronto Stock Exchange (TSX) proposed corporate governance and security-based compensation website disclosure requirements. Proposals by the federal government to change the rules for director elections are a potential cause for concern. Shareholder engagement was a focus of several important initiatives.

DIVERSITY DISCLOSURE

As detailed in our “2016 Diversity Disclosure Practices” report, little progress has been made year-over-year in improving the level of representation of women on boards and in executive officer positions. For companies overall, there was little or no change in the percentage of women directors (13% in 2016 vs. 12% in 2015) and women executive officers (15% both years) or in the percentage of companies without any women on the board (47% in 2016 vs. 46% in 2015). There was some increase in the percentage of companies adopting board diversity policies (34% in 2016 vs. 30% in 2015) and targets for women directors (10% in 2016 vs. 8% in 2015), with Canada’s larger companies taking the lead. However, a few corporate leaders have 50% or more women directors or 50% or more women executive officers.

Meanwhile, Canadian governments have demonstrated their clear interest in board diversity – the Province of Ontario announced a target that women should make up at least 40% of all provincial board and agency appointments.
by 2019 and the federal government introduced proposed amendments to the Canada Business Corporations Act (CBCA) to require CBCA companies to send annual diversity disclosure to shareholders. Unless a significantly higher percentage of TSX-listed companies take meaningful action in this regard soon, there is a very real likelihood that Canadian companies will be confronted with a legislative response that introduces mandatory targets for board diversity.

**TSX WEBSITE DISCLOSURE PROPOSALS**

The TSX tabled proposals to broaden the scope of company website disclosure requirements. These proposals captured certain corporate governance documents that are not currently required to be disclosed and are not commonly disclosed voluntarily, including board mandates, committee charters and whistleblower policies. The proposals would also have subjected all security based compensation arrangements, including plans and individual awards not granted pursuant to a plan, to disclosure on the company’s website. In addition, the TSX’s corresponding proxy circular disclosure requirements would have been simplified. However, in light of concerns expressed by stakeholders regarding these proposals, the TSX is expected to introduce revised website disclosure rules in 2017.

(For more information, please refer to our Osler Update entitled “TSX’s proposed website disclosure rules will expand corporate governance and security based compensation disclosure” on osler.com.)

**OSC WHISTLEBLOWER INCENTIVES PROGRAM**

The OSC’s new Office of the Whistleblower went live in July 2016, offering financial incentives to those reporting potential violations of Ontario securities law to regulators, whether or not such individuals first report their concerns to the company. At the same time, the Securities Act (Ontario) was amended to prohibit reprisals against whistleblowers and invalidate contractual restrictions against making whistleblower reports to regulators. Companies should be looking to reinvigorate their whistleblower policies and practices to more effectively encourage internal reporting and facilitate resolution of potential concerns in response to these developments to avoid being taken surprise by a regulatory investigation.

(For more information, please refer to our Osler Update entitled “A review of new whistleblower protections under Ontario’s Securities Act” on osler.com.)

**DIRECTOR ELECTIONS**

Proposed amendments to the CBCA were tabled in Parliament in September 2016. These would not only eliminate staggered board elections and slate voting (by requiring all directors to be elected annually and each director to be elected separately), but would also introduce a problematic new majority voting standard for director elections in uncontested meetings. Under the new standard, in an uncontested meeting to elect directors, shareholders would be able to vote “against” director nominees and each candidate would be elected only if the number of votes cast “for” the candidate exceeds the number of votes cast “against” the candidate.

Unlike majority voting practices for director elections required under TSX listing rules and voluntarily adopted by other companies, there would be no opportunity for the board to make a determination about whether or not to accept the resignation of a director who failed to receive majority support on
election. As a result, the proposed amendments create a risk that those directors who are elected by the requisite majority might not be able to meet quorum requirements, or might fail to comply either with residency requirements under corporate law or independence requirements under securities laws or stock exchange rules and, therefore, be unable to act. Companies who share these concerns should make their views known as soon as possible.

(For more information, please refer to our Osler Update entitled “Significant corporate governance changes in proposed amendments to the Canada Business Corporations Act” on osler.com.)

SHAREHOLDER ENGAGEMENT

Several initiatives were launched in 2016 with a view to enhancing communications between companies and their shareholders. The Canadian Securities Administrators sought comments on proposed protocols to improve reconciliation of proxy votes from beneficial owners of shares. The Institute of Corporate Directors declared that boards of directors of Canada’s listed companies should directly engage with their significant investors on matters of corporate and board governance and issued guidance on director and shareholder engagement. Among the proposed CBCA amendments were changes to enable CBCA companies to take full advantage of securities law rules which permit delivery of proxy materials to shareholders electronically via notice-and-access. Finally, the report of the Business Law Advisory Council to the Ontario Ministry of Government and Consumer Services recommended amendments to the OBCA that would permit shareholders to resubmit proposals to a corporation if the initial proposal received a prescribed (and minimal) level of support at the previous shareholders’ meeting (in lieu of the current two-year wait period for resubmission of proposals). If implemented, this change would align the OBCA and CBCA in this regard.

The past year has been a busy one for corporate governance in Canada and the stage has been set for a number of the issues that emerged this year to come to a head in 2017. This suggests that further important developments are on the horizon and that companies will need to continue to actively monitor the fast-evolving Canadian corporate governance landscape.

AUTHORS

Andrew MacDougall
Partner, Corporate
amacdougall@osler.com
416.862.4732

Rob Yalden
Partner, Corporate
ryalden@osler.com
514.904.8120

John M. Valley
Associate, Corporate
jvalley@osler.com
416.862.5671
While securities enforcement activity ramped up in the United States in 2016, contested regulatory enforcement cases in Canada were overshadowed by a number of significant record-setting “no-contest” settlements in Ontario that secured approximately $250 million in compensation and returned fees to clients.

Although there were few court cases of note on the regulatory front in Canada, a number of jurisdictions gave themselves new tools to employ in their battles against capital market abuses. The OSC became the first regulator in Canada to introduce a “bounty-based” whistleblower policy. This policy is being hailed by the OSC as a “game changer” and an important means through which to obtain crucial evidence needed to pursue a number of complex securities violations, such as insider trading, market manipulation and sophisticated fraud, which have historically eluded regulators. Québec’s securities regulator, the Autorité des marchés financiers (AMF), also launched its own “whistleblower” program this year, albeit one that does not offer monetary rewards to whistleblowers and instead focuses on offering protections to those who come forward and report misconduct.

These expanded enforcement initiatives come after securities regulators in 2015 collectively imposed twice the amount of monetary sanctions than were imposed in 2014, in addition to imposing the highest aggregate amount of monetary sanctions since 2009.

THE OSC AND AMF LAUNCH WHISTLEBLOWER PROGRAMS

In an effort to encourage the reporting of corporate misconduct, in July 2016, the OSC launched its Whistleblower Program and the Office of the Whistleblower. Modelled on the whistleblower program introduced a few years ago by the SEC, but with some key differences, the OSC’s program offers a monetary “bounty” to individuals reporting information to the regulator that leads to successful regulatory action against perpetrators of securities law violations.
Under the OSC’s program, where whistleblower tips lead to an administrative proceeding which results in a sanction or settlement, whistleblowers may be eligible for a reward of 5% to 15% of the total sanctions imposed and/or voluntary payments made where they exceed $1 million in total. The first $1.5 million awarded to a whistleblower is not contingent on the regulator collecting those sanctions, and rewards are capped at a maximum of $5 million. The OSC’s approach differs from the SEC’s whistleblower program, which has no cap on the total award amount, and which has paid out awards as high as US$30 million in 2014 and US$17 million in June 2016. While culpable whistleblowers are eligible for an award under the OSC’s program under certain circumstances, whistleblowers’ rewards are likely to decrease in line with their complicity in the reported misconduct.

Individuals with compliance roles – for example, internal or external auditors, Chief Compliance Officers, directors, officers and in-house counsel – are eligible for OSC whistleblower rewards in certain circumstances, such as when a minimum of 120 days have passed since they internally reported the misconduct through the appropriate procedure. Employees outside these roles may report straight to the OSC and are not required to first report potential corporate misconduct through internal workplace channels in order to be eligible for a whistleblower reward. This approach could undermine the culture of compliance in some companies by creating incentives for employees to bypass internal processes in favour of reporting directly to the OSC in the hope of obtaining lucrative whistleblower awards.

The new Whistleblower Program also provides protection for employees who come forward and report misconduct. The Ontario Securities Act (OSA) was recently amended to prohibit reprisals against whistleblowing employees by their employers and to void any confidentiality provision that prevents employees from reporting corporate misconduct. The OSC has the power to enforce these anti-reprisal provisions through its public interest jurisdiction under the OSA. In addition, the OSC is required to use “all reasonable efforts” to protect whistleblowers’ identities except where the whistleblower consents or where disclosing his or her identity is necessary to allow the respondent to make full answer and defence in an administrative proceeding.

The Office of the Whistleblower received more than 30 tips in its first two-and-a-half months. According to the newly appointed OSC Chair, Maureen Jensen, these tips detail securities law violations that the OSC has been targeting in its securities enforcement actions, such as accounting misstatements and improper failures to disclose, which the OSC would not have been able to find without the tips.

The AMF’s whistleblower program, by contrast, does not provide financial rewards for those who report securities law violations and focuses on offering protections to whistleblowers. Under the AMF’s program, whistleblowers are given the benefit of informer privilege and the protection of various anti-reprisal measures, such as immunity from possible civil suits that arise from reporting the misconduct.
NO-CONTEST SETTLEMENTS REACH RECORD HIGHS

The introduction of the OSC’s Whistleblower Program coincides with the regulator’s approval of a series of record-breaking no-contest settlements. Introduced in 2014 as part of the OSC’s Credit for Cooperation program to reward industry participants for reporting misconduct and cooperating with the regulator, no-contest settlements allow alleged wrongdoers in administrative proceedings to settle with the OSC without admitting to an offence.

Prior to 2016, the largest no-contest settlement approved by the OSC was a $13.5 million settlement with a large Canadian financial institution in November 2014 regarding excess client fees. That settlement was dwarfed in February 2016 by a no-contest settlement under which an investment management firm agreed to return $156.1 million to harmed investors as a result of allegations that the value of certain mutual funds were inaccurately calculated.

Additional no-contest settlements approved by the OSC in 2016 also surpassed the previous high-water mark. In July 2016, an approximately $20 million settlement with three dealers of a Canadian financial institution was approved regarding fee overcharges that had not been detected by the dealers’ internal control systems. The OSC approved an even larger no-contest settlement with several dealers at another Canadian bank in October 2016. Those dealers agreed to compensate clients a total of $73.3 million, including opportunity costs, in connection with excess fees. Despite the significant increase in no-contest settlement amounts this year, the OSC’s settlements are considerably smaller than those entered into and approved by the SEC, including a controversial settlement made between the SEC and Citigroup for US$285 million.

RECENT DECISIONS HIGHLIGHT JURISDICTIONAL REACH, DEFERENCE TO PROVINCIAL REGULATORS AND PRIVATE PARTY STANDING

The most common securities violations targeted by regulators in 2015 were illegal distributions, fraud and insider trading. In 2016, several judicial and regulatory decisions had important implications for securities enforcement:

- **McCabe v. British Columbia (Securities Commission):** The British Columbia Court of Appeal confirmed that the B.C. securities regulator has jurisdiction over alleged securities law wrongdoing where there is a real and substantial connection between the misconduct and the province, even where the link between the regulator’s province and the misconduct is not as strong as the link between the misconduct and another province.

- **Fiorillo v. Ontario Securities Commission:** The Ontario Divisional Court clearly signalled that appellate courts will grant a high degree of deference to the OSC’s specialized knowledge of financial markets. In dismissing an appeal from an OSC decision finding that the appellants had engaged in insider trading and tipping, the Court noted that it was not uncommon in insider trading and tipping cases for the bulk of the evidence to be circumstantial. Osler represented one of the parties to the appeal. (At the time of writing, the OSC’s decision in Finkelstein, where a panel made a similar finding in reliance on circumstantial evidence, was still under appeal.)

- **Corus Entertainment:** The OSC narrowed private party standing for public interest (section 127) applications in contested transactions. The Catalyst Group, which opposed Corus Entertainment’s proposed acquisition of Shaw
Media, was denied standing to bring an application under the OSC’s public interest jurisdiction for an order requiring Corus to amend or supplement its management information circular. Given the tactical timing of the request, this would have forced Corus to delay its special meeting. The decision in Corus significantly narrows the scope of private party standing under section 127 of the OSA and represents a rollback of previous decisions on this issue. Osler represented Corus in this proceeding.

R. v. Peers: The Supreme Court of Canada granted leave to appeal from a decision of the Alberta Court of Appeal that concluded that charges under Alberta’s Securities Act (the ASA) do not warrant a jury trial. Section 11(f) of the Charter grants individuals the right to a trial by jury where the maximum punishment for an offence is five years’ imprisonment or a “more severe punishment.” In Peers, the individuals charged with offences under section 194 of the ASA, which has a maximum penalty of imprisonment for five years less a day, plus a fine of up to $5 million, argued that the potential punishment amounted to a “more severe punishment” and that they therefore had a right to a jury trial. The Alberta Court of Appeal disagreed, finding that the legislature deliberately chose five years less a day of imprisonment as the maximum penalty in order to avoid having complex securities matters dealt with by jury trials.

With the new tools recently given to securities regulators in Ontario and Québec to help combat capital market abuses, regulators are hoping for meaningful advancements in securities enforcement in Canada. For now, however, it seems that regulatory enforcement activity is limited, with a sparsity of contested hearings relative to prior years. Moreover, while the OSC’s Whistleblower Program has already seen some early success in encouraging tips, none of these tips, understandably, has yet progressed to the stage of a public enforcement proceeding or the payment of a whistleblower award. The future effectiveness of whistleblower programs in Ontario and Québec may encourage other provincial securities regulators to expand their enforcement toolkits and adopt similar programs.
In 2016, plaintiffs continued their attempts to circumvent the protections offered to defendants under the Ontario Securities Act against secondary market claims. These attempts were largely unsuccessful, and the protections provided to defendants from unmeritorious securities class actions continue to be relatively robust.

**PLAINTIFFS ATTEMPTS TO UNDERMINE THE STATUTORY PROTECTIONS**

The secondary market right of action in Part XXIII.1 of the Ontario Securities Act was built on a balancing of interests and includes safeguards – such as a merits-based leave stage and liability limits – which are designed to protect issuers and other defendants from unmeritorious litigation and devastating liability.

In recent years, the most significant securities class action developments centered on the statutory leave test for bringing a secondary market claim. The interpretation of this test was largely settled by the Supreme Court of Canada’s 2015 decisions in *Theratechnologies* and *CIBC*.

As a result, developments in 2016 tended to address other issues arising from creative plaintiffs’ attempts to undermine the protections offered by the Securities Act. These were largely unsuccessful. Several decisions in 2016 should give many market participants confidence that Ontario courts are prepared to recognize and uphold the hard-won protections in Part XXIII.1.
In particular, plaintiffs’ counsel sought to circumvent the statutory protections by:

i. seeking to bring claims of secondary market purchasers under the primary market right of action, which lacks many of the same protections for issuers and other market participants;

ii. seeking to bring claims against underwriters under the secondary market right of action, which could expose underwriters to significantly increased liability; and

iii. seeking to frame secondary market claims against less conventional defendants like investment banks on the basis that they are “influential persons”.

**PRIMARY VS. SECONDARY MARKET RIGHTS OF ACTION**

The primary market right of action relates mainly to misrepresentations affecting the price of securities issued under, for example, a prospectus (Part XXIII of the Ontario Securities Act).

The secondary market right of action relates mainly to misrepresentations in an issuer’s continuous disclosure obligations that affect the price of securities purchased or sold in the secondary market (Part XXIII.1 of the Ontario Securities Act). Part XXIII.1 provides certain safeguards to defendants in secondary market claims, including the requirement that plaintiffs obtain leave of the Court before commencing an action, and liability limits.

In two recent decisions, Ontario courts have confirmed the crucial distinction between the two rights of action and denied plaintiffs’ attempts to circumvent the protections in the respective rights of action.

In *Rooney v. ArcelorMittal SA*, the Court of Appeal for Ontario confirmed that security holders who sell shares in the secondary market in the face of a takeover bid cannot bring a primary market claim under Part XXIII alleging misrepresentations in a takeover bid circular.

In *LBP Holdings v. Allied Nevada Gold Corp.*, the Ontario Superior Court of Justice denied the plaintiff’s attempt to commence a statutory secondary market claim against underwriters in relation to alleged misrepresentations in an offering document. Justice Belobaba held that underwriters could not be sued as “experts” in a secondary market claim covered by Part XXIII.1. The Securities Act distinguishes between experts and underwriters and Part XXIII (primary market claims) provides a ‘complete code’ for underwriter liability.

**INVESTMENT BANKS AS PROMOTERS – “SOMETHING MORE” IS REQUIRED**

Plaintiffs’ counsel have also tried to frame claims against less conventional defendants, particularly where the issuer is facing current or potential insolvency.

In *Goldsmith v. National Bank of Canada*, the Court of Appeal for Ontario confirmed important limitations on the exposure of investment banks and other advisors. The Court refused to extend the meaning of the term “promoter” in Part XXIII.1 (secondary market claims) to cover conventional banking and advisory services.
Under Part XXIII.1, a right of action for alleged misrepresentation lies against a promoter that “knowingly influenced” the issuer or its directors and officers to, for example, release a document containing a misrepresentation or fail to make timely disclosure. The Court held that, to come within the definition of “promoter,” a person or entity must take a leading role in the organization or reorganization of the company. This means that the person must be active and autonomous and have meaningful control. Merely providing advice to the company’s decision-makers is not sufficient, regardless of the importance of that advice. As the Court of Appeal put it, “something more” than advice and banking services is required for a capital market participant such as National Bank to qualify as a “promoter.”

**REASONABLE INVESTIGATION DEFENCE**

A question that remains to be determined is the level of evidence that is needed to dispose of unmeritorious secondary market claims at an early stage – for instance, at the leave stage – by establishing a statutory defence such as the reasonable investigation defence under Part XXIII.1 of the Ontario *Securities Act*.

In *Rahimi v. SouthGobi Resources*, the Ontario Superior Court of Justice held that the directors and officer defendants had conducted a reasonable investigation by, among other things, relying on the advice of the company’s auditors. The Court therefore denied the plaintiff’s motion for leave to commence a secondary market action against the directors and officers, but allowed the motion against the issuer. The Court held that the issuer, which had restated its financial statements and admitted weaknesses in internal controls, had not met the high threshold needed to make out the reasonable investigation defence at the leave stage.

In May 2016, the issuer was granted leave to appeal to the Divisional Court on the basis that there is reason to doubt the correctness of the order. In particular, Justice Stewart reasoned that if the directing minds of the issuer had conducted a reasonable investigation, then the issuer must also have conducted a reasonable investigation. The defence bar is keeping a close eye on this appeal. If the court confirms that there will be instances in which the issuer can establish a reasonable investigation defence on the evidence filed at the leave stage notwithstanding the lower “reasonable possibility of success” standard, it would be a powerful tool for defendants seeking to dismiss unmeritorious litigation at an early stage.

There will be other developments in 2017 and beyond that could affect the question of whether it is sufficient to rely on auditors’ advice to make out the reasonable investigation defence – and what boards of directors should do to lay the groundwork for this defence. The appeal to the Supreme Court of Canada in the *Livent* case may clarify issues relating to audit standards and the audit process. There will certainly be more litigation and clarification surrounding the application of the reasonable investigation defence in the context of reliance on auditors’ advice.
CONCLUSION

Although securities class actions remain a meaningful risk for issuers and others, market participants have reason for optimism that Ontario courts have generally recognized the protections in Part XXIII.1, including a meaningful leave stage and statutory defences.

AUTHORS

Allan Coleman  
Partner, Litigation  
acoleman@osler.com  
416.862.4941

Laura Fric  
Partner, Litigation  
lfric@osler.com  
416.862.5899

Lawrence E. Ritchie  
Partner, Litigation  
lritchie@osler.com  
416.862.6608

Rob Carson  
Associate, Litigation  
rcarson@osler.com  
416.862.4235
Northern Gateway loss may be a win for industry

Aboriginal issues and the duty to consult continue to be among the primary risks to resource development in Canada. While the basic legal principles that govern Aboriginal consultation in Canada are well established, consultation requirements for both project proponents and the Crown can be elusive in practice and execution. This was highlighted in the recent Federal Court of Appeal decision in Gitxaala Nation v. Canada, which overturned the federal government’s approval of Enbridge’s Northern Gateway Project – a multi-billion dollar pipeline system proposed to run from Edmonton, Alberta to Kitimat, British Columbia. The Gitxaala decision created additional hurdles for the Northern Gateway Project, which was ultimately rejected by the federal government on November 29, 2016. At the same time, Gitxaala provides helpful clarity in relation to the duty to consult that may allow future projects to avoid a similar outcome.

Gitxaala was the culmination of more than a dozen legal challenges commenced by Aboriginal groups and environmental organizations seeking to overturn the federal government’s approvals for the Northern Gateway Project on the basis that (1) the Joint Review Panel assigned to review the project failed to properly consider environmental effects and (2) Canada failed to adequately consult with affected Aboriginal peoples concerning the project.

This litigation followed a nine-year regulatory process that commenced in 2005 and involved one-and-a-half years of public hearings before the Joint Review Panel. In December 2013, the Joint Review Panel released its report recommending that the project be approved subject to 209 conditions. The federal government then conducted additional direct consultation with affected Aboriginal groups.
over the first half of 2014. In June 2014, the federal Cabinet issued Orders in Council approving the project and directing the National Energy Board to issue certificates allowing the project to proceed. The Court in Gitxaala quashed these Orders in Council and the subsequent certificates on the basis that the federal government failed to fulfill its duty to consult with Aboriginal groups prior to issuing the Orders in Council. The matter was remitted to the Cabinet for reconsideration and additional Aboriginal consultation.

Due to the size and location of the project and the considerable local opposition, Northern Gateway’s regulatory process was unique. In early 2009, before a Joint Review Panel had been appointed or any public hearings were held, the federal government released a project-specific Crown consultation plan for the project. This plan contemplated five separate phases of consultation, the first three of which would occur through the regulatory process. Phase IV would occur following the release of the Joint Review Panel’s report and would involve direct consultation by the federal government to address project-related concerns outside the Joint Review Panel’s mandate. Finally, Phase V would involve additional consultation regarding specific permits and authorizations for the project following the federal government’s approval, assuming the project was approved.

The Federal Court of Appeal conducted a detailed factual analysis of each of the first four phases of the consultation process (the fifth phase had yet to occur) to determine whether the consultation was adequate. The Court concluded that Aboriginal groups were provided with ample opportunities to participate in the regulatory process, and that it was appropriate for Canada to rely on this regulatory process to fulfill aspects of its duty to consult. The Court also lauded Enbridge’s efforts to consult with Aboriginal groups, including its extensive direct engagement with potentially affected groups and its provision of capacity funding to assist their participation in the process. As a result, the Court found that consultation through the first three phases of the consultation process was adequate.

With respect to Phase IV, however, the majority of the Court characterized Canada’s consultation as “brief, hurried and inadequate.” Among other things, the Court found that (i) Canada failed to fully discuss many specific concerns raised by Aboriginal groups or provide any direct response to their specific requests for information, including requests for Canada’s assessment of the level of consultation that was owed; (ii) the Crown Consultation Coordinators mischaracterized the positions of several groups in the reports that were provided to Cabinet; and (iii) the Crown Consultation Coordinators were only tasked with collecting information from Aboriginal groups within prescribed timelines and had no authority to make decisions on behalf of the government. The Court found that this latter aspect of the Crown’s consultation precluded meaningful two-way dialogue on matters of importance to the Aboriginal groups.

The majority of the Court stated that it would have taken Canada little time and little organizational effort to engage in meaningful dialogue on the subjects of prime importance to Aboriginal peoples, but this did not happen. As a result, the majority concluded that Canada’s consultation was inadequate and the duty to consult was not satisfied.

Mr. Justice Ryer dissented, finding that in the context of the overall project-approval process, execution of the Phase IV consultation was adequate. Justice Ryer would have dismissed all applications and appeals challenging the project.
Both the federal government and Enbridge publicly announced in September that they did not intend to appeal the Federal Court of Appeal’s decision to the Supreme Court of Canada. On November 29, 2016, the federal government announced that the Northern Gateway had been formally rejected.

While the Gitxaala decision was one of the final obstacles that ultimately led to the Northern Gateway Project’s demise, there are several aspects of the Gitxaala decision that will be beneficial for future projects that trigger the duty to consult Aboriginal peoples:

1. *Gitxaala* confirms that the regulatory process can play an important role in fulfilling the duty to consult, and that the processes followed by the Joint Review Panel and the proponent for Northern Gateway were acceptable. This will provide useful guidance to regulators and proponents for future projects.

2. Both the majority and dissent rejected the challenges relating to consideration of environmental effects, affirming that the federal Cabinet has broad discretion to consider economic, environmental and cultural issues in its determination of whether to approve major pipeline projects. This aspect of the decision should make it more difficult to challenge future project approvals on environmental grounds.

3. While the details in *Gitxaala* are specific to the unique circumstances of Northern Gateway (and the Crown’s five-phased consultation plan), the decision provides helpful guidance to governments on how to conduct direct consultation with Aboriginal groups to ensure that the consultation is meaningful.

4. Despite the fact that the majority in *Gitxaala* concluded that Canada’s consultation was inadequate, it suggested that adequate consultation could have occurred within the same time frame and that it should not take much additional time to remedy the deficiencies. This suggests that meaningful consultation does not necessarily require extensions to Canada’s existing consultation processes.

In our experience, satisfying the legal requirements for Aboriginal consultation requires a robust strategy and execution plan to ensure compliance, as well as rigorous discipline to ensure the various parties charged with responsibility for consultation fulfill those obligations. The *Gitxaala* decision provides useful guidance for both proponents and governments on what is required to meet the legal requirements for Aboriginal consultation as well as pitfalls that must be avoided to ensure that project approvals withstand judicial review.

**AUTHORS**

**Shawn Denstedt Q.C.**
National Co-Chair of the firm
sdenstedt@osler.com
403.260.7088

**Sander Duncanson**
Associate, Regulatory, Environmental, Aboriginal and Land
sduncanson@osler.com
403.260.7078
In response to mounting public concern over tax avoidance and evasion, the federal government in Budget 2016 announced the dedication of an additional $444.4 million to the Canada Revenue Agency (CRA) over the next five years to combat these issues. A Standing Committee on Finance was convened to study the CRA's efforts in this regard. The federal funds are slated for hiring additional auditors and specialists and combatting criminal tax evasion, and are expected to generate an additional $2.6 billion in revenue for the federal government.

In light of public scrutiny, it is not surprising that 2016 has seen the CRA increase the number and scope of its audits, take aggressive positions under the general anti-avoidance rule (GAAR) and the transfer pricing rules, and impose penalties at unprecedented levels.

We expect this environment of heightened audit and assessment activity to persist in the near term. Businesses should closely examine tax risk management practices, monitor key legal developments and adjust tax planning accordingly, as well as ensure that appropriate processes are in place to prepare for increased audit scrutiny.
ELEVATED AUDIT ACTIVITY

The Standing Committee on Finance reported to Parliament in October that the CRA currently has 20% more auditors than it had in 2006. The CRA continues to take a risk-based approach when auditing large corporations, focusing its efforts on aggressive and international tax planning. The CRA also noted before the Standing Committee that the reputation of a company’s tax advisors can influence its decision about whether to audit.

Information gathering efforts by the CRA have increased in 2016, a trend that is expected to continue in light of the additional resources devoted to audit activity and the advent of country-by-country reporting, an audit risk assessment tool arising from the OECD/G20 base erosion and profit shifting project. Broadly worded requests and formal information requirements are now routinely used to compel delivery of taxpayer information. These can represent a significant burden on taxpayer resources, almost akin to a litigation discovery process.

GUIDANCE EXPECTED ON CRITICAL ISSUES

A number of large corporate taxpayers are poised to take their high-profile disputes with the CRA over GAAR and transfer pricing reassessments before Canadian courts. Decisions in these and similar cases will be critical in defining key issues facing Canadian corporate taxpayers, including multinationals with operations in Canada.

The interaction between the GAAR and legislative amendments that apply prospectively to counter particular forms of transactions that the CRA finds objectionable was debated in two Tax Court of Canada cases in 2016, with different results. In the Univar case, the taxpayer unsuccessfully appealed a GAAR reassessment of transactions that were targeted by a specific anti-avoidance rule introduced after the transactions took place. In the Oxford Properties decision, however, the Tax Court declined to accept the CRA’s argument that legislative changes introduced after the taxation period at issue reflected pre-existing tax policy. Both decisions have been appealed to the Federal Court of Appeal.

In a number of pending appeals, the Tax Court will also be called upon to consider the scope of the CRA’s “recharacterization” power under the transfer pricing rules to override the legal effect of transactions undertaken by multinational groups. Although these rules have been in place for nearly 20 years, the recharacterization provision has yet to be interpreted by the courts.

TRANSFER PRICING PENALTIES SOAR

Transfer pricing penalties have continued to soar in 2016. CRA data shows that penalties were up tenfold in 2015 from the previous year. Total penalties assessed for transfer pricing cases in the aggregate have increased from $58.6 million in 2012 to $479 million in 2015, with $225 million assessed between January and June 30, 2016. The average penalty for individual transfer pricing reassessments...
has risen from $3.45 million in 2012 to $16 million in 2015, with an average of $12.5 million in 2016. Penalties weigh heavily on taxpayers, not only because they can cause reputational damage, but also because they cannot be offset by other tax attributes. As with the recharacterization rule, the transfer pricing penalty provisions have not yet been the subject of judicial guidance, and will be on the Tax Court’s agenda for 2017.

With the devotion of more resources to the CRA’s audit division and the public scrutiny of its commitment to combatting perceived tax avoidance, we expect that the number and significance of tax disputes in Canada will continue to rise in the near term. The courts’ decisions in the coming years will be important in achieving fairness and predictability for taxpayers, a key goal of the Canadian tax system.
As we close out 2016 with deal volume down in the private equity space, much attention is being paid to PE’s so-called “dry powder” – their unspent cash reserves on hand. According to Preqin’s “2016 Preqin Global Private Equity & Venture Capital Report”, the global amount of dry powder has now topped US$1.3 trillion, the highest since the data provider’s records began in 2000. This growing pile of cash reserves is not surprising given that the buy-out space is becoming increasingly crowded. Not only are there new private equity firms emerging all over the globe, but the competitive landscape is also shifting with Chinese multinationals, sovereign wealth funds and pension funds all wielding their financial clout and confident in their ability to make direct and often solo investments.

Case in point was the October announcement that the Ontario Teachers’ Pension Plan had agreed to buy the Canadian operations of Constellation Brands for $1.03 billion. The dominance of the Canadian pension plans in the domestic and international M&A game is nothing new. As The Economist explored in its October 22, 2016 article “The Barbarian Establishment,” many “other kinds of entities with access to cheap and often state-related capital have entered the buy-out market.” Given their investment capability and expertise, not to mention their deep pools of capital, these buyers are more and more often seen as direct single buyers when quality assets and businesses are put up for auction.

Data over the past several years show that appetite for direct investments by limited partners in private equity and venture capital deals has remained elevated. PitchBook Platform data found that in 2015, limited partners were involved in 168 completed deals, a 23% rise from 2012. This appetite for direct investing can be troubling for the general partners of private equity funds who
have historically relied – and continue to rely – on investments in their funds from institutional investors such as sovereign-wealth funds and pension plans.

What does it mean when your investor client becomes your competitor? For most funds, it means continuing to allow co-investment rights (and accompanying lower fees) in the hope that the large LPs will decide not to invest directly but rather be alongside the fund as a co-investor. To withhold co-investment rights or structure or price them in a manner inconsistent with the market gives rise to the risk that these deep-pocketed limited partners walk away from the fund. According to Preqin’s report on private equity co-investment, 69% of general partners actively offered co-investment opportunities to their limited partners, and a further 18% are considering doing so in the future. On the other hand, according to the report, 26% of limited partners are actively co-investing and 24% are opportunistically co-investing.

Historically, investors agreed to commit monies to a fund sponsor (the general partner) and the partnership agreement would, among other things, dictate how the general partner would allocate capital, requirements for asset diversification, the target investment size and the timing for exiting investments. While this is still the process, it is now increasingly common for limited partners to require that the fund documents contemplate co-investments. Co-investments allow limited partners to effectively bypass the fund and invest directly in the targeted company. Co-investments are still coordinated and agreed to by the general partner and the co-investor, but the terms, including the fees payable to the general partner, will vary from those applicable to the limited partners in the fund.

The fees payable to the general partner on co-investments vary from fund to fund and in some cases are zero. Funds with formal co-investment programs will often attempt to set the fee structure at the time of the establishment of the fund. In other funds, the fee and/or carried interest payable will be a matter of negotiation with co-investors at the time of the investment. In either case, the overall fee package for co-investors will usually be lower than the incentive income-sharing arrangements in the main fund (with some funds still commanding the classic 2% management fee and the 20% carried interest arrangement). The availability of co-investment rights can also be a matter of negotiation when funds are being launched; some general partners may grant such rights only to select investors (generally, its largest or most loyal, or those that are perceived to be strategic investors), while others have conceded that all limited partners will be entitled to co-investment rights.

While co-investment rights are gaining in popularity and many LPs demand them in order to invest in a fund, in reality there are still only a limited number of LPs that are able to deliver, given that timing to get the deal done is often tight and the required cheque size can be large. Private equity transactions that anticipate co-investors participating should provide for appropriate deal mechanics and conditions, such as an appropriately drafted non-disclosure agreement permitting disclosure to potential co-investors, and ensure that enough time is given to bring the co-investors to the table.

Some general partners might have preferred the passive money of old. However, most are willing to accept the new state of play and accompanying overall lower fees to ensure the availability of flexible and committed capital. Participation by large institutions in a co-investment capacity provides private equity funds with
the flexibility to execute large transactions without having to look outside their investor group for third party capital. In a world where deal flow is slowing, committed capital and the ability to show up at the table with a big cheque can make all the difference.

From the limited partner perspective, co-investments can improve their prospects of boosting returns with more favourable fee arrangements and in a more controlled manner. For some, in particular those building out their own internal investment teams, co-investments offer the opportunity to invest alongside experienced general partners, and can give them experience in direct investment disciplines. Given all these positives, it is difficult to imagine that the co-investment trend will slow any time soon.

AUTHORS

Mary Abbott  
Partner, Corporate  
mmabbott@osler.com  
416.862.4217

John Groenewegen  
Partner, Corporate  
jgroenewegen@osler.com  
416.862.6458
Corporate recapitalizations as an alternative to insolvency proceedings

In the current economic environment, and in particular as a result of low oil and gas prices affecting the energy sector, corporations in financial difficulty are increasingly turning to the arrangement provisions of the Canada Business Corporations Act (CBCA) or equivalent provincial corporate statutes to restructure corporate bonds and similar debt obligations. CBCA arrangements have proven to be an effective and flexible alternative to formal insolvency proceedings to restructure or recapitalize certain debt obligations and achieve other fundamental changes to a corporation’s capital structure. A successful CBCA arrangement proceeding can be completed in a much shorter timeframe than a restructuring under the Companies’ Creditors Arrangement Act (CCAA) or the Bankruptcy and Insolvency Act (BIA), is potentially less costly than an insolvency filing and has fewer repercussions for a corporation’s business and its reputation.

CBCA arrangements are an attractive alternative where a company does not need to restructure its contractual obligations, stay significant litigation or obtain a liquidity lift by staying payment of pre-filing obligations but is under pressure due to debt on its balance sheet that is not supported by its forecast EBITDA. The key to success is to build a consensus with major securityholders and lock up support for the arrangement long before the first court appearance.

ARRANGEMENT APPROVAL PROCESS

A CBCA arrangement is effected through a plan of arrangement that is generally approved by the holders of a super-majority (i.e., two-thirds) of the value of the affected securities and sanctioned by a court. Unlike a vote on an insolvency plan, where a plan must be approved by a double majority consisting of
two-thirds in value and a majority in number of affected creditors in a given class, a CBCA arrangement vote does not also require approval by a numeric majority of the holders of the security in question.

The court proceeding formally begins with an application for an interim order that authorizes the company to call one or more meetings of affected securityholders to vote on the plan of arrangement. In addition, the interim order often imposes a stay of the rights and remedies of any securityholder that is to be affected by the proposed plan of arrangement. Courts have also granted a stay of any cross-default provisions that may be triggered by a default arising under the affected securities. The stay is normally much narrower than the stay granted in an insolvency proceeding, where a broad stay applies to the rights and remedies of creditors, contractual counterparties and other stakeholders.

Once the interim order is granted and the plan of arrangement is approved by the requisite majority of securityholders who attend the meeting(s), an application is made to the court for a final order sanctioning the plan as fair. Following the final order, the plan can be implemented to exchange or extinguish either debt or equity securities and/or to compromise the corresponding obligations in exchange for the consideration contemplated by the plan.

**SHORTER TIMEFRAME**

In the right circumstances, a final order approving a plan of arrangement under the CBCA can be obtained in less than 60 days from the commencement of the proceedings. A CBCA arrangement is often completed in a matter of months, whereas an insolvency restructuring generally takes longer (though either form of restructuring can be completed in a shorter timeframe in the right circumstances).

The formal commencement of CBCA arrangement proceedings is often the culmination of intense negotiations that begin long before any court materials are served. A company seeking to restructure its debt should begin negotiation of a support agreement with major securityholders well in advance of the occurrence of a looming default. A support agreement is designed to ensure that the outcome of the meeting to approve the plan of arrangement is determined before it is called.

**PRE-NEGOTIATED OUTCOME**

A typical support agreement will, at a minimum, set out the principal terms of the arrangement as well as bind the supporting securityholders to vote in favour of the arrangement and to forbear from enforcing any remedies. It will also prohibit supporting securityholders from pursuing alternative arrangements with other interested parties.

Initial supporting securityholders will frequently receive an early mover premium in addition to the consideration given to all securityholders under the arrangement. The carrot represented by the premium is often coupled with a stick: the support agreement can require the company to file for insolvency protection and implement an alternative restructuring transaction on the occurrence of certain events, including failure to obtain support from shareholders or other securityholders in the capital stack. The threat of an insolvency and the corresponding potential for value erosion are often enough to bring stakeholders to the table. This is particularly effective for shareholders, who stand to lose their entire investment if the company becomes insolvent.
NO NEED TO ADMIT INSOLVENCY

CBCA arrangements may be available to insolvent corporations so long as one of the applicant companies is solvent or the corporation will become solvent as a result of the arrangement. Unlike a company seeking insolvency protection, a corporation undergoing a CBCA arrangement proceeding does not need to admit insolvency and is not prohibited from paying its trade creditors in the ordinary course. Short-term trade credit is usually not affected. The company can continue to do business as usual, with minimal impact on employees, customers or suppliers. Some shareholder value can be preserved. Professional fees tend to be lower than in an insolvency due to the shorter length of the proceedings and the fact that fewer stakeholders are affected by or participate in the process.

AN ATTRACTIVE ALTERNATIVE

In the right circumstances, a CBCA arrangement is an attractive alternative to formal insolvency proceedings. There are limits to the types of restructurings that can be accomplished using a CBCA arrangement. The CBCA arrangement provisions have not typically been used to restructure traditional bank debt (though examples do exist) and have not been used to complete operational restructurings or to address commercial contractual arrangements. In addition, a CBCA arrangement does not permit a company to seek a super-priority charge to secure any new funds that the company needs to complete the arrangement. However, where a corporation is looking to reorganize its capital and compromise securities and does not require additional liquidity, a CBCA arrangement can be a flexible and effective tool to accomplish these objectives.

Osler has been involved in some of the country’s largest and most complex CBCA restructurings this year, including Tervita Corporation, Trident Exploration Corp. and Postmedia Network Canada Corporation. Osler was lead counsel for Tervita Corporation and for Trident Exploration Corp., which are two of the very few successful CBCA debt restructuring arrangements that have occurred in Alberta in the current economic environment. While a CBCA restructuring has some limitations, it is a powerful tool that can be deployed in the right circumstances.

AUTHORS

Andrea Whyte  
Partner, Corporate  
amwhyte@osler.com  
403.260.7035

Patrick Riesterer  
Associate, Insolvency & Restructuring  
piriesterer@osler.com  
416.862.5947

Marc Wasserman  
Partner, Insolvency & Restructuring  
mwasserman@osler.com  
416.862.4908
SPACs seek to complete qualifying acquisitions

The deadlines for completing an acquisition for the special purpose acquisition corporations (SPACs) that were created in a wave in 2015 are approaching. As we commented previously (see “Special Purpose Acquisition Corporation (SPAC) offerings: Will we see more?” on osler.com), whether SPACs will continue to be a viable asset class will likely depend on whether this group of initial SPACs is successful in completing a “qualifying acquisition” — an acquisition by the SPAC of a business with the escrowed proceeds of the initial equity offering.

The chart below provides a summary of the deadlines by which each of the 2015 SPACs (and one completed in 2016) must complete its qualifying acquisition:

<table>
<thead>
<tr>
<th>SPAC</th>
<th>Initial Deadline</th>
<th>Extended Deadline</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dundee Acquisition Ltd.</td>
<td>January 21, 2017</td>
<td>April 21, 2017</td>
</tr>
<tr>
<td>INFOR Acquisition Corp.</td>
<td>February 27, 2017</td>
<td>May 27, 2017</td>
</tr>
<tr>
<td>Alignvest Acquisition Corporation</td>
<td>March 24, 2017</td>
<td>June 24, 2017</td>
</tr>
<tr>
<td>Acasta Enterprises Inc.</td>
<td>April 30, 2017</td>
<td>July 30, 2017</td>
</tr>
<tr>
<td>Kew Media Group Inc.</td>
<td>June 13, 2017</td>
<td>December 13, 2017</td>
</tr>
<tr>
<td>Gibraltar Growth Corporation</td>
<td>July 2, 2017</td>
<td>N/A</td>
</tr>
</tbody>
</table>
For each SPAC, the initial deadline may be extended to 36 months after the closing of the initial public offering with shareholder approval and the consent of the TSX, if required. The extended deadline for each of the first four SPACs in the chart applies if the SPAC has executed a letter of intent, agreement in principle or definitive agreement for a qualifying acquisition by the initial deadline. In the case of Kew Media, the initial deadline may be extended twice by 3 months each time upon the subscription by the sponsor or other founders for $525,000 of units.

To date, four proposed transactions have been announced, although none of these SPACs has yet completed a qualifying acquisition.

INFOR Acquisition Corp. (“IAC”) announced on July 25, 2016 that it had entered into an arrangement agreement with Element Financial Corporation. The agreement provided for an arrangement of IAC pursuant to which IAC would be acquired by the company carrying on the North American commercial finance business to be spun off from Element. This transaction, which would have been the first completed qualifying acquisition by a SPAC, was terminated by agreement of the parties on October 12, 2016 shortly before the proposed meeting of SPAC shareholders called to consider the transaction.

Dundee Acquisition Corp. (“DAC”) announced on August 25, 2016 that it had entered into an arrangement agreement with CHC Student Housing Corp. The agreement provides for an arrangement of DAC pursuant to which DAC will be acquired by CHC and the combined entity will acquire certain additional student housing properties. DAC intends to hold a meeting of shareholders on December 20, 2016 with closing of the transaction expected to occur in December.

Alignvest Acquisition Corporation (“AAC”) announced on November 1, 2016 that it had entered into an arrangement agreement with Trilogy International Partners LLC. The agreement provides for an arrangement of AAC as a result of which AAC will acquire up to a 51% equity interest (and a 100% voting interest) in Trilogy. AAC intends to mail an information circular to shareholders by late December, 2016 in connection with a meeting of shareholders anticipated to be held by late January 2017 with closing of the transaction expected to occur shortly after the meeting of shareholders.

Acasta Enterprises Inc. (“AEI”) announced on November 10, 2016 that it had entered into agreements to acquire two private label consumer staples businesses and a commercial aviation finance advisory and asset management business. Completion of the transactions is expected to occur in January, 2017.

Although the proposed transactions are not completed, there are nevertheless some interesting developments of interest to market participants arising from them:

• SPAC founders may have to reduce their “promote” or otherwise modify their initial investment to complete a qualifying acquisition;

• A qualifying acquisition includes a sale of the SPAC, including one which results in the SPAC shareholders acquiring a minority interest in the on-going business; and

• An arrangement of a SPAC may require approval by a simple majority (i.e. over 50%) of shareholders rather than the typical two-thirds approval for an arrangement.
The founders of a SPAC provide seed financing by acquiring units of the SPAC (shares and warrants) at the same price as the public investors in the IPO. The seed financing covers underwriting fees and legal and other expenses associated with the IPO and qualifying acquisition. Before its IPO, the founders of a SPAC acquire initial shareholdings for nominal consideration. These “founder shares” compensate the founders for the risk they have assumed with their seed capital, for their efforts in organizing the SPAC and for their ability to source and execute a successful qualifying acquisition. Twenty-five percent of these shares are subject to forfeiture for a period following completion of a qualifying acquisition if certain share trading price thresholds are not achieved over time.

In each of the IAC and DAC proposed transactions the founders agreed to reduce the value accretion to be realized from their founders shares on completion of the qualifying acquisition. In the case of IAC, the founders agreed to reduce the value of their founders’ shares by 80% and, in the case of DAC, the founders agreed to reduce the value of their founders’ shares by 25%. The sponsor of AAC has agreed to invest an additional $21 million at the IPO price of $10 per share and, together with certain other founders, has agreed to a lock-up of a portion of its shares for a period following closing of the qualifying acquisition (in addition to the shares subject to forfeiture). The founders of AEI have increased the number of their founders’ shares that are subject to forfeiture if certain share trading price thresholds are not achieved over time, have increased such share trading price thresholds from those originally established at the time of the IPO and have agreed to invest an additional $10 million at the IPO price of $10 per share.

As noted above, each of the proposed IAC and DAC transactions was structured as an arrangement under corporate law, the steps of which included the acquisition of the shares of the SPAC. While it may be counter-intuitive that a qualifying acquisition could include a sale of the SPAC, the acceptance by the TSX of this structure as a qualifying acquisition was likely based on acceptance of the argument that the transaction is, in effect, a “merger” of the SPAC and the acquiror, since a merger is specifically contemplated as a potential qualifying acquisition in a SPAC prospectus. It should also be noted that the IAC transaction contemplated the SPAC shareholders effectively acquiring only a minority interest in the on-going business.

An interesting aspect of the proposed DAC transaction and the proposed AAC transaction is that each arrangement agreement contemplates that the shareholder approval threshold for the SPAC will be a simple majority of the votes cast in respect of the shareholders’ resolution approving the arrangement. Typically, the approval threshold for shareholders of a corporation that is being arranged is two-thirds (or greater in some jurisdictions) of the votes cast in respect of the shareholders’ resolution. Under applicable corporate law, this threshold is established by order of the court in its discretion but, in practice, it has consistently been established by the court as the same threshold that applies to other “fundamental changes” under applicable corporate law such as amendments of articles, amalgamations and reorganizations.

Each of DAC and AAC is incorporated under the Business Corporations Act (Ontario) (OBCA). The OBCA provides that subject to any interim order of the Court, where an arrangement is approved by shareholders by special resolution (i.e. by two-thirds of the votes cast) the corporation may apply to the Court for
approval of the arrangement. Clearly, the court has discretion to order a different shareholder approval threshold, but the presumption is that the threshold will be two-thirds. This presumption is further evidenced by the provision of the OBCA that provides for the making of the interim order. It provides that the court may make any interim order it considers appropriate, including an order that an arrangement must be approved by a specified majority that is greater than two-thirds of the votes cast at the meeting of shareholders.

The interim order of the court for the arrangement of DAC provides for an approval threshold of a simple majority. Counsel for DAC noted in its materials filed with the court that a simple majority approval threshold is consistent with the requirements of the TSX applicable to a SPAC’s qualifying acquisition. Counsel also noted that the voting requirements in the interim order do not mean that the court has “set” or “established” the appropriate voting threshold which can be addressed at the court hearing to be held following the meeting of shareholders at which the court will be asked to approve the arrangement as fair and reasonable. Notably, at the time of this fairness hearing, the actual level of approval of shareholders will be known.

We believe that an argument that may be persuasive and differentiating to the court in accepting a simple majority shareholder approval threshold for the arrangement of a SPAC as opposed to the typical arrangement shareholder approval threshold of two-thirds is that, in the case of a SPAC, any shareholder of the SPAC (whether it votes in favour of or against the arrangement or does not vote) may require the SPAC to redeem its shares for its pro rata share of the escrowed cash of the SPAC. Accordingly, as contrasted with the situation in a typical arrangement in which a shareholder would be required to sell its securities in the market (which may not reflect fair value) or dissent and pursue potentially costly litigation to achieve a “fair value” determination by the court in order to exit its investment, a SPAC shareholder can easily “get its money back” if it does not wish to remain invested. The interim order for the DAC arrangement does not provide for dissent rights for this very reason.

We expect that there will be further developments in practice as the existing SPACs and, possibly, new ones move to complete their qualifying acquisitions. Market participants will be watching as the fate of the SPAC structure may hang in the balance.

AUTHORS

Jeremy Fraiberg
Partner, Corporate
jfraiberg@osler.com
416.862.6505

Doug Marshall
Partner, Corporate
dmarshall@osler.com
416.862.4218
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