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Canada's New Rules for Marketing Prospectus Offerings - 10 Things to Know About the Proposed Changes

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On November 25, 2011, the Canadian Securities Administrators (CSA) published for comment proposed changes to the rules on the marketing of prospectus offerings (the proposed rules). We summarized some of the proposals in a previous Osler Update on December 1, 2011.

The market practice in Canada for bought deals, road shows and term sheet usage is long established, so it may come as a surprise to some market participants that there is currently very little law governing these activities. The CSA is therefore proposing rules that it believes codify established market practice and that expand the scope of permissible marketing activities during a prospectus offering in Canada. However, there are a number of possible unintended consequences resulting from some of the proposed rules that, if adopted in their proposed form, could result in significant changes to current Canadian practice. We highlight these issues in this Update and, through the public comment process, will raise these concerns with the CSA.

We encourage others to submit their own comments on the proposed rules to the CSA before the deadline of February 23, 2012.

Bought Deals

1. **The conditions for upsizing a bought deal could be difficult to comply with and may preclude upsizing in many situations.**

When a bought deal agreement is signed, the underwriters make a firm commitment to purchase a specific number of securities at a specific price. The underwriters are then allowed to solicit expressions of interest from potential investors, provided that the bought deal agreement requires the issuer to obtain a receipt for a preliminary prospectus not more than four business days after the date the bought deal agreement is entered into and certain other conditions are satisfied.

If the offering is oversubscribed after soliciting expressions of interest, issuers and underwriters have on occasion amended their bought deal agreement prior to filing the preliminary prospectus to enlarge or "upsize" the offering. The Canadian rules do not currently contain clearly prescribed requirements for upsizing a bought deal. The Canadian securities regulators have expressed policy concerns about upsizing, as it may provide a means for an underwriter to solicit expressions of interest for an offering that is ultimately significantly larger than the underwriter's original purchase commitment. These concerns have created uncertainty regarding when and how a bought deal can be upsized. The CSA is now attempting to resolve this uncertainty through specific rules prescribing the conditions for an upsizing. The proposed rules will also regulate making other amendments to bought deal agreements, and the termination provisions they may contain.

The CSA is proposing to cap the amount by which a bought deal can be upsized following launch to either 15%, 25%, 50% or some other prescribed percentage of the original size of the offering. (The CSA has requested comments on what the prescribed percentage should be, and we encourage market participants to express their view on the appropriate percentage through the comment process.)

Importantly, the proposed rules would also prohibit a bought deal from being upsized if doing so is “the culmination of a formal or informal plan to offer a larger number of securities under the short form prospectus devised before the execution of the original agreement”. This condition is presumably aimed at making sure there is no intention to upsize before launching a bought deal, and that it is only excess demand or over-subscription that results in the upsized offering, rather than using a subsequent upsizing as a means of circumventing the spirit of the bought deal rules by permitting solicitations of expressions of interest in securities for which there is no pre-existing purchase commitment by an underwriter.

However, the wording of this condition is very broad, and may be viewed as applying to the discussions that issuers and underwriters will typically have regarding the interplay of offering price and offering size prior to the launch of an offering, and the impact that market demand will ultimately have on the underwriters’ ability to complete a larger offering at a particular price. Further, it is fairly typical for the possibility of upsizing to be discussed as part of the original negotiation of the bought deal terms. It is not at all clear when such discussions amount to a “formal or informal plan”.

We believe that this new condition may introduce needless uncertainty regarding the ability to upsize a bought deal, and should not be necessary in light of the proposal to cap increases at a fixed percentage of the original offering size.

2. **There are other proposed restrictions on amending and terminating bought deal agreements that may be incompatible with current market practice.**

The proposed rules appear to prohibit a bought deal agreement from being terminated unless all parties (including the issuer) decide not to proceed with the prospectus offering or unless a permitted termination event occurs. The proposed rules do not permit a bought deal agreement to contain a “market out” termination right, which is consistent with current market practice. However, bought deal agreements normally do contain other termination rights such as a “disaster out” and a “due diligence out”. Additionally, the underwriting commitment in the bought deal agreement is usually subject to the subsequent condition that the issuer and the underwriters execute a mutually satisfactory form of definitive or formal underwriting agreement.

Under the proposed rules, it is not clear whether these types of termination rights and conditions would be prohibited, as they can result in the termination of a bought deal agreement without the consent of the issuer. If this is the intended result, it will require a significant change in current market practice. Further, it is not clear whether these restrictions apply only to the initial bought deal bid letter, or also apply to the definitive or formal underwriting agreement itself (which may unintentionally be captured by the definition of “bought deal agreement” as currently proposed). Finally, the proposed rules would prohibit any amendment to a bought deal agreement in order to add additional representations, warranties, indemnities and conditions, unless the amended agreement is “otherwise on the same terms” as the original agreement. It is not clear what is intended by this requirement. It is also not clear whether this requirement is intended to apply to the definitive or formal underwriting agreement, which by superceding and replacing the bought deal agreement may be considered to constitute an amendment to it.

The proposed rules also prohibit adding a new underwriter to the syndicate if this is “the culmination of a formal or informal plan to add that underwriter devised before the execution of the original agreement”, which is not reflective of current market practice. Most bought deal agreements are executed by a single underwriter, in the interests of speed in bringing the offering to market, with the full expectation that other underwriters will subsequently be invited to join an underwriting syndicate. We do not understand the regulatory concerns with the current practice.

3. **Term sheets for a bought deal may be sent only to institutional investors before the preliminary prospectus receipt is issued.**

Between the launch of a bought deal and when a receipt is issued for the preliminary prospectus, term sheets may only be sent to institutional investors. Retail investors may receive a term sheet after a preliminary prospectus receipt is issued, but this will be of little practical benefit unless a portion of the offering is reserved for retail investors, as bought deals are generally fully allocated well before the preliminary prospectus is filed.

We believe that retail investors should be entitled to receive term sheets. We do not understand the policy rationale for limiting access only to institutional investors, particularly when it is proposed that all information concerning securities in the term sheet must be included in the launch news release or the issuer's continuous disclosure record.

The proposed rules would also require a copy of the preliminary prospectus to be sent to each permitted institutional investor that received the term sheet, whether or not that investor expressed interest in the offering or ultimately purchases securities. This is likely to create an unnecessary compliance burden for underwriters, as no purpose is served by providing further information about an offering to an investor that has already decided not to participate in the offering.

4. **The bought deal press release will require more disclosure.**

The proposed rules would require all information concerning the securities in the bought deal term sheet to be included in the launch press release, unless that information has been disclosed by the issuer in a previously filed document. For instance, some of the information in a typical bought deal term sheet that would need to be included in the launch press release under the proposed rules would include the stock exchange(s) where the issuer's securities are listed, the termination provisions for the underwriting commitment, the eligibility for investment of the securities for RRSPs, TFSAs and other registered plans and the underwriting fee. Current market practice is to not include this information in the launch press release. It is not clear why this information should be needed in the press release when investors participating in the offering will ultimately receive it through the term sheet or the prospectus.

5. **The term sheet must be filed before it can be used.**

Under current bought deal rules, the launch press release must be issued and filed on SEDAR prior to the commencement of solicitation activities. For timing reasons, this is typically handled by the lead underwriter on behalf of the issuer. Under the proposed rules, the term sheet would also need to be approved in writing by the issuer and the underwriters and filed on SEDAR before the term sheet is sent to institutional investors. We anticipate that this will result in the lead underwriter also filing the term sheet at the same time as the press release in order to be in a position to be able to distribute the term sheet to institutional investors immediately upon launch.

Road Shows

6. **All information in a road show during the waiting period must also be included in the preliminary prospectus.**

Under the proposed rules, all information in a road show during the waiting period must also be disclosed in the preliminary prospectus, with the exception of comparable company information, which may only be disclosed to institutional investors. We understand that the CSA believes this is largely consistent with current Canadian road show practice. However, the proposed rules are very restrictive and require that “all information” in the road show also be in the preliminary prospectus, rather than focusing only on material information. Further, the proposed rules do not distinguish between presentation material that is shown or distributed to investors and the statements made by management or others during the presentation itself.

We believe that it is impractical and inconsistent with current market practice to prevent management from being able to answer questions during a road show simply because the answers go beyond what is contained in the preliminary prospectus, or because of uncertainty regarding whether the answer entails providing any information (whether or not material) that is not included in the preliminary prospectus.

The CSA has also asked for comments on whether the use of comparable company information should be more regulated, including through rules aimed at reducing the risk of “cherry picking” comparables.

7. **It is unclear whether a slide deck for a road show would always need to be filed on SEDAR and included or incorporated by reference in the prospectus.**

For the typical road show that occurs during the waiting period, the proposed rules would prohibit an investment dealer from providing “written material” to an investor attending a road show, other than the preliminary prospectus and any amendment, unless the written material is treated as a term sheet under the proposed rules. This would mean filing the written material on SEDAR and including or incorporating by reference the written material in the prospectus.

It is not clear whether the filing requirement applies when investors are shown the slide deck but are not allowed to keep a copy of it. For example, the slides may be shown on screen during an in-person meeting, or may be handed out for viewing only during the meeting with all copies collected afterwards, or presented though the internet in a format that does not allow printing or downloading. It is unclear why written materials such as a road show slide deck should be filed on SEDAR and otherwise treated like a term sheet if they are being provided in a form that cannot be retained by investors.

8. **The new road show requirements will create a significant impediment for Canada / U.S. cross-border IPOs.**

The proposed rules would require that road show materials be filed on SEDAR, and the proposed companion policy provisions discussing road shows for cross-border IPOs appear to be premised on the assumption that this means that an electronic road show will constitute “road show materials” that must be filed on SEDAR, even if the content cannot be downloaded or printed. The CSA suggests that cross-border IPO issuers will no longer be required to apply for the type of exemptive relief previously granted in Canada for cross-border IPOs (and such relief will no longer be available absent unusual circumstances) because issuers will be able to file on SEDAR the same road show materials that they are permitted to file on EDGAR. As the CSA points out, for an internet road show for an IPO, the U.S. requirement is that road show materials either be filed on EDGAR or be “made generally available without restriction” through electronic means. The CSA appears to be under the impression that road show materials are typically filed on EDGAR in the United States, and that the need for the previously granted exemptive relief stemmed from a concern that the public availability of the road show materials on EDGAR would violate Canadian marketing restrictions, as the SEC's EDGAR website is available worldwide, including to Canadian investors.

In fact, road show materials are rarely, if ever, filed on EDGAR. U.S. underwriters typically insist on making a bona fide version of the road show available to the public without restriction for the express purpose of avoiding the alternative requirement to file the road show on EDGAR. Although a number of commercial services allow investors in the United States (and elsewhere, including Canada) to view the road show, access is always limited to viewing only, with no capability for investors (or others) to print or download the content, or access it after the permitted viewing period expires. U.S. underwriters are generally concerned that they would be subject to a significantly higher risk of frivolous and ultimately unmeritorious lawsuits being brought against them and the issuer by the active U.S. plaintiff securities litigation bar if a record of the contents of the road show slides and script is made permanently available on EDGAR.

Any road show material that is required to be filed on SEDAR in Canada will also be permanently available to the U.S. securities class action bar, and we anticipate that U.S. underwriters would raise the same concerns about that result in the context of a cross-border IPO. Further, because the proposed Canadian rules will still require restricting access to electronic road shows in Canada (even if only for the purpose of verifying the identity of the viewers), the U.S. rules will require that a bona fide version of the road show must also be filed on EDGAR as well. The result will be a significant change from current U.S. IPO practice.

We are concerned that this change from current practice may create a disincentive for IPOs to be conducted on a cross-border basis. We anticipate that U.S. issuers and underwriters will be reluctant to participate in a cross-border IPO unless road show content which is protected from downloading and printing is exempt from any SEDAR filing requirement, and the CSA continues to provide exemptive relief to allow unrestricted access to such road shows in Canada so that they may continue to be exempt from the SEC's EDGAR filing requirements.

9. **The proposed rules do not specifically address confidential marketing in advance of a shelf prospectus take-down.**

Confidential marketing in advance of a public offering, where investors agree to be restricted from trading and to keep the transaction confidential until it is announced or abandoned, has become more common in recent years, both in Canada and the United States. Most market participants would consider this type of confidential marketing to be permissible in Canada under current rules, as long as the issuer has a shelf prospectus in place and rules relating to insider trading and tipping are complied with.

A new provision in the proposed rules states that, if an issuer does not issue a news release about a potential drawdown under a shelf prospectus, dealers should consider measures to ensure compliance with applicable securities laws relating to selective disclosure, insider trading and trading by "tippees" (i.e., investors who are told about an offering being confidentially marketed). This would include obtaining confidentiality commitments from potential investors with respect to information about a potential offering.

Although this provision appears to acknowledge that a shelf takedown may be confidentially marketed in Canada, it may be helpful to market participants for the CSA to provide further clarity regarding its expectations for the conduct of such offerings.

10. **The proposed rules do not provide guidance on when it is permissible to launch an offering following a "non-deal road show".**

The CSA indicates in the proposed rules that it is aware of the practice that has developed for "non-deal road shows", where issuers and dealers will meet with institutional investors to discuss the business and affairs of the issuer. The proposed rules state that, if a non-deal road show was undertaken in anticipation of a prospectus offering, it would be prohibited under securities legislation. However, there is no guidance or prescribed "cooling off period" under the proposed rules regarding when it would be acceptable to launch a public offering following an issuer's non-deal road show.

This would appear to leave the current practice with respect to non-deal road shows unchanged, in that it would still be up to the issuer and dealers to satisfy themselves that a non-deal road show is not undertaken in anticipation of a prospectus offering, either based on the facts or by imposing their own cooling off period between the end of the non-deal road show and launch of a public offering.

If you have any questions or comments on the proposed rules please contact any of the authors of this Update or any other Osler lawyer.