

Corporate Securities Law

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Ontario Securities Commission Proposes Rule for Distributions Outside Ontario

On June 30, 2016, the Ontario Securities Commission (OSC) published for comment Proposed OSC Rule 72-503 - *Distributions Outside of Canada* (the “**Proposed Rule**”), as well as an accompanying form (the “**Proposed Form**”) and companion policy (the “**Proposed Companion Policy**”). The Proposed Rule is intended to clarify the scope and application of the prospectus and registration requirements in certain cross-border transactions. The OSC is accepting written comments on the Proposed Rule until September 28, 2016.

Under the *Securities Act* (Ontario), the terms “distribution” and “trade” are defined in such a way that a distribution of securities in a foreign jurisdiction might also be considered a “distribution” under Ontario securities laws. Consequently, the distribution would need to be qualified by a prospectus and would invoke certain registration requirements. Historically, the OSC has attempted to limit the burden of such technical compliance through the publication of Policy 1.5 - *Distributions of Securities Outside Ontario* and the subsequent publication in 1983 of Interpretation Note 1 - *Distributions of Securities Outside Ontario* (the “**Interpretation Note**”), which would be withdrawn with the adoption of the Proposed Rule.

The Existing Regime

The Interpretation Note provides that, where an issuer and intermediaries implement reasonable precautions to

ensure that securities distributed outside Ontario “come to rest” outside of Canada, and there is no negative impact on the integrity of Ontario’s capital markets, such distributions need not be qualified by a prospectus. Market participants have criticized the existing regime for failing to establish a bright-line test, which has created uncertainty and made the Interpretation Note difficult to administer. In particular, issuers and intermediaries face difficulties in concluding that reasonable steps have been taken to ensure that securities “come to rest” outside of Canada.

Furthermore, as drafted, the Interpretation Note applies only to distributions by issuers, creating further uncertainty for securityholders wishing to sell securities in foreign jurisdictions (although, in practice, the Interpretation Note has been construed to apply to such secondary sales as well). The combined effect of the uncertainty surrounding the Interpretation Note can result in reduced returns associated with foregone investment opportunities, increased costs of regulatory compliance or the need to sell securities in foreign markets at a discount.

The Proposed Rule

The Proposed Rule - which is drafted to capture any “distribution of securities to a person or company outside of Canada” and would consequently apply equally to both issuers and selling securityholders - aims to alleviate this uncertainty by providing exemptions from the prospectus requirement when securities are distributed outside Canada in the following circumstances:

- the issuance is under a public offering document in the U.S. or a “designated foreign jurisdiction;”¹

¹ “Designated foreign jurisdictions” include Australia, France, Germany, Hong Kong, Italy, Japan, Mexico, the Netherlands, New Zealand, Singapore, South Africa, Spain, Sweden, Switzerland and the United Kingdom of Great Britain and Northern Ireland.

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- a concurrent distribution of the issued securities is qualified by a prospectus in Ontario;
- the issuer has been a reporting issuer in a jurisdiction of Canada for the four months immediately preceding the distribution; and
- for all other distributions outside Canada, provided that the first trade of such securities to a person in a jurisdiction of Canada will be subject to certain resale restrictions (including a four-month hold period).

The hold period imposed in the final exemption (for distributions back into Canada) is a function of the fact that some form of disclosure document - whether it be a U.S. registration statement, a Canadian prospectus, etc. - would exist for distributions made pursuant to the other exemptions.

With the exception of an issuance under a public offering document in the U.S. or designated foreign jurisdiction, issuers relying on the prospectus exemptions under the Proposed Rule will be required to electronically file the Proposed Form within 10 days of the distribution date.

The Proposed Rule also provides an exemption from the dealer and underwriter registration requirements for distributions outside of Canada where the dealer or underwriter meets certain prescribed conditions.

Although the Proposed Rule is aimed at resolving uncertainty surrounding the Interpretation Note, it may nevertheless lead to similar concerns. For example, the Proposed Companion Policy continues to suggest that issuers, underwriters and other participants “take reasonable steps to ensure that the securities come to rest outside of Canada,” yet does not articulate what such “reasonable steps” might include. It is difficult to reconcile this overarching principle with the “bright-line” exemptions provided in the Proposed Rule, and such uncertainty is heightened when sales are made on a foreign stock exchange, where the identity of the purchaser is unknown and could, in theory, be a Canadian.

The uncertainty that remains in the Proposed Rule suggests that those wishing to distribute securities outside of Canada may continue to be forced to pursue alternative routes to do so on a prospectus exempt basis (such as, for example, under the prospectus exemption in section 2.14 of National Instrument 45-102 - *Resale of Securities*). These alternatives, however, carry with them their own uncertain elements and could continue to lead to foregone investment opportunities, regulatory compliance costs and price discounts.

For more information on the Proposed Rule or corporate finance in general, please contact any member of our Corporate Securities Group.