Goodmans LLP Update

PIPE Transactions in Canada: Key Considerations for U.S. Investors

Private investment in public equity (PIPE) transactions have become increasingly common in Canada recently, a trend that has accelerated due to the impact of COVID-19 on financial markets and cash flow. Canadian companies seeking to strengthen their balance sheets are considering PIPEs as an alternative to more traditional capital markets financing options. In some cases, this is because PIPEs offer an attractive combination of flexibility, execution speed and certainty, and few regulatory hurdles. In others, it is because more traditional financing alternatives are simply not available. Either way, Canadian PIPEs frequently involve U.S.-based investors. For example, in April 2020, Oaktree Capital Management LP and Engaged Capital, LLC invested US$60M in SunOpta Inc., a plant-based food and beverages company, in exchange for exchangeable preferred shares, in May 2020, WildBrain Ltd., a global leader in kids and family entertainment, raised C$25 million from Fine Capital Partners, L.P. through the issuance of exchangeable debentures and in September 2020 Tricon Residential Inc., a rental housing company focused on serving the middle-market demographic in North America, received a US$300 million exchangeable preferred share investment from a syndicate of investors led by Blackstone Real Estate Income Trust. Other recent examples of Canadian PIPE transactions include Brookfield Asset Management Inc.'s June 2020 US$260 million exchangeable preferred share investment in Superior Plus Corp., an energy distribution and specialty chemicals company.

In many ways, Canadian PIPEs look very much like U.S. PIPEs. They involve the issuance of securities to a single or small group of investors pursuant to an exemption from the prospectus requirements under Canadian securities laws. PIPE transactions typically involve equity or equity-linked securities, such as convertible debentures, preferred shares and warrants. Investors may receive a number of rights or preferences as part of the transaction including pre-emptive rights to participate in future offerings, board representation or observation rights, registration rights, and sometimes veto rights in respect of certain matters (such as amending the company's articles or by-laws, issuing new securities, assuming additional indebtedness, or making substantive changes to the company's business plan or operations). As a result, U.S. investors who are considering a Canadian PIPE transaction will find themselves on reasonably familiar ground.

Despite these similarities, there are a number of differences that must be considered for a Canadian PIPEs. Canadian corporate and securities laws, stock exchange, regulatory and tax requirements and considerations must all be taken into account when investing across the border and can significantly affect deal terms and structures. This article highlights some of the uniquely Canadian aspects of PIPEs that U.S. investors and their advisors should keep in mind when considering a Canadian PIPE.

Canadian Corporate and Securities Law Considerations

Articles of Amendment

PIPE transactions often involve the creation and issuance of 'bespoke' securities with specifically negotiated terms and conditions. If the security to be issued is a new class of securities not currently permitted under the issuer's articles, the articles will have to be amended to create the security (some Canadian issuers' articles provide for "blank cheque" preferred shares that can be issued without shareholder approval, but this is relatively rare). Under Canadian corporate law, amending an issuer's articles requires shareholder approval, which effectively results in the PIPE itself being subject to shareholder approval. To avoid the uncertainty and

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delay associated with seeking that approval, the parties can consider structuring the transaction as the issuance of debt (or convertible debt) securities or having the investor invest in securities issued by a subsidiary of the issuer that are exchangeable for the publicly-traded equity securities of the issuer.

Prospectus Exemptions

As is the case in the U.S., the sale of securities under a Canadian PIPE must be made in reliance on an exemption from Canadian prospectus requirements. The "accredited investor" exemption (which is based on, and similar to, the accredited investor exemption under U.S. securities laws) will almost always be available given the size and sophistication of investors who typically participate in PIPE transactions.

Alternatively, if the issuer is based in Ontario and the investor is outside of Canada, the issuer may avail itself of the exemption in Ontario Securities Commission Rule 72-503 – *Distributions Outside Canada* ("**Rule 72-503**") which permits sales to investors outside of Canada if the issuer has materially complied with or is exempt from the disclosure requirements applicable to the distribution under the applicable foreign securities laws.

Resale Restrictions

Securities sold under a Canadian PIPE may be subject to a four- month statutory hold period, during which the securities cannot be resold in Canada except pursuant to another exemption or under a prospectus If the investor is a control person – meaning someone who holds more than 20% of the outstanding voting securities of the issuer or enough shares to "materially affect" control of the issuer –further restrictions on resale will apply. If an issuer relies on the exemption under 72-503, no hold period should apply under Canadian securities laws.

Insider Transactions

If the PIPE investor is an insider of the issuer at the time of the transaction, additional disclosure and procedural requirements will apply. In particular, under Multilateral Instrument 61-101 – *Protection of Minority Security Holders in Special Transactions* ("**MI 61-101**"), unless an exemption is available, an issuer that wishes to complete a PIPE to an insider must obtain and disclose a "formal valuation" and "majority of the minority" shareholder approval before it can complete the transaction. MI 61-101 is a highly technical rule that can sometimes yield surprising results and should be carefully considered at the early stages of a potential PIPE.

Public Reporting

Insider reporting and early warning requirements under Canadian securities laws will apply if the PIPE investor is (or will become) an insider. An "insider" includes any person who beneficially owns or controls more than 10% of the voting or equity securities of any class of a public company, or securities convertible into 10% or more of such securities. Under the early warning regime (roughly equivalent to 13D reporting obligations under the U.S. Securities Exchange Act), an investor whose ownership of public company securities crosses the 10% threshold must "promptly" issue a press release and file an early warning report on the System for Electronic Document Analysis and Retrieval (SEDAR).[1] In addition, under the insider reporting rules, the investor will be required (unless it is filing its early warning reports under the alternative monthly reporting system) to disclose its shareholdings by filing an insider report on the System for Electronic Disclosure by Insiders (SEDI) within 10 days of the transaction that brought the investor's ownership above 10%.

Stock Exchange Requirements

A company that completes a PIPE transaction must comply with the rules of the stock exchanges on which its securities trade. If the transaction involves securities of a company which trade on the Toronto Stock Exchange (TSX), the TSX must be notified of the transaction and must approve the terms of the private placement.[2] A number of TSX requirements must be considered in connection with a PIPE, including the following.

[1] Institutional investors may, in certain circumstances, instead take advantage of an alternative monthly reporting system under which the investor is not required to issue a press release and may delay the filing of its early warning report until the 10th day of the month following which the reportable event occurred.

[2] This article does not address the requirements of any other of Canada's stock exchanges whose requirements are generally equal to or less onerous than the requirements of the TSX.

Pricing Limitations

The TSX places limitations on the price at which a listed issuer may issue listed shares (or securities convertible into or exchangeable for listed shares) without receiving shareholder approval for the transaction.

The issue price of listed shares must be not less than the market price of the shares at the time the transaction is agreed or announced minus a maximum discount that ranges from 15% - 25%. The TSX allow issuers to obtain "price protection" for a potential transaction for a limited period of time by providing notice of the transaction to the exchange in advance of its announcement. In the case of convertible or exchangeable securities with a fixed conversion or exchange price, the TSX will generally require that the conversion or exchange price be not less than market price at the time of the transaction.

Dilution Limitations

The TSX will require shareholder approval for a PIPE transaction that:

- materially affects control of the issuer[3], OR
- involves the issuance of more than 25% of the issuer's outstanding listed securities (assuming the conversion or exchange of any convertible or exchangeable securities to be issued) at a discount to market price.

In circumstances where the parties wish to avoid seeking shareholder approval for a PIPE that would otherwise exceed one or both of these thresholds, it may be possible to use structures such as limitations on voting rights, the issuance of non-voting securities or breaking the investment into tranches.

Insider Participation

In addition to the general limitations on dilution described above, if the PIPE investor is an insider of the issuer, the TSX will also require shareholder approval if the PIPE, taken together with any other transactions in the preceding six months, involves the issuance to insiders of listed securities (or rights or other entitlements to listed securities) that exceeds 10% of the number of outstanding securities of the issuer (on a non-diluted basis). The "look back" nature of this test means that the issuer's ability to complete a PIPE with an existing 10%+ shareholder may be constrained by other, unrelated, equity issuances to insiders within the prior six months.

Other Requirements

There are a number of other TSX requirements that could be relevant in a PIPE transaction. These include:

- absent shareholder approval, the TSX will generally not allow "price based" anti-dilution adjustments to the conversion or exchange price of a convertible or exchange security to reduce the conversion / exchange price below market price at the time of the transaction; and
- if the transaction will create a new 10%+ shareholder, before the transaction closes that shareholder (and its directors, if the shareholder is a corporation) must complete and file a detailed "personal information form" (PIF) and the TSX must also complete and be satisfied with its review of the PIF prior to closing (which includes certain background checks). This process takes time and should be considered as part of the overall deal timeline and started relatively early in the process.

Exemptions

TSX rules include some exemptions from the requirement to seek shareholder approval for a transaction. These include:

- *Eligible Interlisted Issuers.* A TSX-listed issuer that is also listed on a "Recognized Exchange" (including the NYSE, NASDAQand the LSE) and has had less than 25% of its trading volume occurring on Canadian marketplaces in the 12 months preceding a proposed transaction, will generally not be required to seek shareholder approval for the transaction as a result of the application of TSX rules.

[3] A transaction will generally be deemed to materially affect control of an issuer if it results in the creation of a new 20%+ shareholder unless the circumstances suggest otherwise.

- *Financial Hardship.* An issuer that is in "serious financial difficulty" and is undertaking a transaction to improve itsfinancial situation, may apply to the TSX for an exemption from a requirement to seek shareholder approval that would otherwise apply to the transaction. The application must meet certain conditions, including establishing why the issuer isunable to hold a shareholder meeting before completing the transaction. The TSX examines financial hardship applicationsclosely and will require clear evidence of immediate financial distress that precludes the issuer from bringing a proposed transaction to shareholders before it will be prepared to approve the exemption.

Regulatory Issues

Investment Canada Act ("ICA")

If a PIPE transaction results in a non-Canadian investor acquiring more than 1/3 of the voting securities of a publicly traded Canadian company, the transaction may be subject to review under the ICA, depending on whether certain financial thresholds are met. The financial thresholds depend on the investor's identity. For a "trade agreement investor" – meaning an investor that is controlled by a country that is party to certain trade agreements, such as the North American Free Trade Agreement – the transaction is only reviewable if the enterprise value of the Canadian business exceeds C$1.613 billion. Investors from the U.S. would fall into this category.

However, the financial threshold for review is much lower for cultural businesses in Canada. A "cultural business" includes a business that carries on any of the following: the publication, distribution or sale of books, magazines, or newspapers; the production, distribution, sale or exhibition of film, video, or audio recordings; the publication, distribution or sale of music; or any business activities involving radio, television and cable television broadcasting. For any cultural business, the threshold for review is C$5 million in book value of assets of the business for direct investments and C$50 million in book value of assets of the business for indirect investments. If subject to review, the transaction cannot close until the Minister under the ICA has approved the transaction.

Competition Act (Canada)

If the PIPE transaction would result in the investor (including its affiliates) acquiring more than 20% of the voting securities of the issuer, the transaction may be subject to pre-merger notification under Canada's *Competition Act*, depending on whether the transaction exceeds the party size and transaction size thresholds set out in the *Competition Act*. Pre-merger notification will generally be required for transactions where the target has assets in Canada or revenues in or from Canada generated from those assets of C$96 million or more, and where the parties to the transaction have assets in Canada or revenues from sales in, from or into Canada of C$400 million or more. If the transaction is subject to notification, the initial review period is 30 days. If the Competition Bureau issues a supplementary information request during the initial review period, the transaction cannot be completed until 30 days after compliance with the supplementary request.

Other Regulatory Requirements

In addition to the requirements imposed by the ICA and the *Competition Act*, companies in certain industries (such as banking, telecommunications, transportation and broadcasting) are required to maintain certain levels of Canadian ownership which must be considered if an investment is contemplated in a company operating in these industries. Furthermore, companies in certain industries – such as the film and media industry and the publishing industry – sometimes receive various tax credits and other incentives that are predicated on the company being Canadian controlled. These factors must be taken into account, and sometimes structured around, when considering a PIPE investment in an issuer in one of these industries.

Tax Issues

The Canadian tax consequences of a cross-border PIPE should be considered early in the planning stages of a potential transaction. Issues that may be relevant include (i) the potential application of Canadian withholding tax to dividend, interest, redemption and other payments to non-Canadian investors (and, if applicable, which party will be responsible for bearing the cost of any such withholding), (ii) additional taxes (including "Part VI.1" tax) that might be imposed on the issuer in connection with any payments to non-resident investors, and (iii) the issuer's ability to deduct interest payments on any debt securities issued in a PIPE from its taxable income in Canada.

Conclusion

Canadian issuers are increasingly recognizing the advantages of PIPEs and frequently turn to U.S.- based investors as a potential source of capital for these transactions. While Canadian PIPEs often appear, at first glance, to mirror the terms and structures commonly found in U.S. PIPEs, they can be significantly affected by Canadian legal and regulatory considerations. U.S. investors must ensure they clearly understand and appropriately address these considerations to successfully implement a Canadian PIPE.

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