

## Corporate Securities Law

March 11, 2004

### Insider Reporting Requirement For Equity Monetization Transactions Now In Force

#### Overview

In our Corporate Securities Update of March 5, 2003, we outlined an initiative proposed by the Canadian Securities Administrators (the “CSA”) in response to concerns that the existing insider reporting requirements may not apply to derivative-based transactions. On February 28, 2004, Multilateral Instrument 55-103 - *Insider Reporting for Certain Derivative Transactions (Equity Monetization)* (the “Rule”) came into force in Ontario, Alberta, Saskatchewan and Manitoba and imposes a reporting requirement on insiders of reporting issuers in respect of derivative-based transactions, including equity monetization transactions. The Rule is expected to come into force shortly in other provinces.<sup>1</sup>

#### Equity Monetization Transactions Defined

Equity monetization transactions are those which allow an investor to receive a cash amount similar to proceeds of disposition: the investor transfers part or all of the economic risk and/or return associated with the securities of an issuer without actually transferring the legal and beneficial ownership of such securities. The term “monetization” generally refers to the conversion of an asset, such as securities, into cash. A typical transaction would involve an insider selling a call option contract against shares of the company owned by the insider. The insider continues to own the shares but has “cashed out” his or her position.

#### The Insider Reporting Requirement

The Rule does not prohibit insiders from entering into monetization transactions, but imposes a reporting requirement with respect to such transactions. Insiders of a reporting issuer are required to disclose the existence and material terms of equity monetization transactions which they have entered into to the public. Specifically, insiders must file an insider report under the Rule if they enter into, materially amend or terminate an agreement, arrangement or understanding of any kind which:

- changes the insider’s “economic interest in a security” of the reporting issuer, or
- changes the insider’s “economic exposure” to the reporting issuer

and the insider is not otherwise required under any provision of Canadian securities law to file an insider report about the agreement, arrangement or understanding.

If an insider is required to file a report under the Rule, the same procedures for filing by way of SEDI (System for Electronic Disclosure by Insiders) are to be used as in the case of an ordinary purchase or sale of securities, and the report must disclose the existence and material terms of the agreement, arrangement or understanding.

An insider who enters into a monetization transaction after February 28, 2004 is required to file a report within 10 days (or such shorter period as may be prescribed) from the day on which the insider enters into, materially amends or terminates the agreement, arrangement or understanding. Failure to file within 10 days will result in late filing fees.

In certain circumstances, the Rule requires that insiders file a report which discloses the existence of monetization arrangements that were entered into *before* the Rule became effective on February 28, 2004. An insider is required to file a report under the Rule if, either prior to the effective date of the Rule or prior to the date the

<sup>1</sup> The British Columbia Securities Commission has decided to implement similar requirements by amending the provincial securities legislation instead of adopting the Rule.

insider most recently became an insider of the reporting issuer, the insider

- entered into an agreement, arrangement or understanding in respect of which the insider would have been required to file an insider report under the Rule if it had been entered into on or after the effective date or the date the insider most recently became an insider, and
- the agreement, arrangement or understanding remains in effect on or after the effective date or the date the insider most recently became an insider.

An insider who has entered into a pre-existing monetization transaction is required to file a report within 10 days (or such shorter period as may be prescribed) from: (i) the effective date of the Rule, if the person or company was an insider prior to such date (the tenth day was March 9, 2004); or (ii) the date the person or company most recently became an insider, if the person or company was not an insider before the effective date of the Rule.

## Exemptions from the Reporting Requirement

The Rule contains a number of broad exemptions from the reporting requirement. In particular, the reporting requirement does not apply to:

- an agreement, arrangement or understanding which does not involve, directly or indirectly, an interest in a security of the reporting issuer (which includes a put, call, option or other right or obligation to purchase or sell securities of the issuer) or a derivative which involves a security of the reporting issuer;
- an agreement, arrangement or understanding in the nature of a compensation arrangement such as a phantom stock plan, deferred share unit (“DSU”) plan or stock appreciation right (“SAR”) plan which would otherwise be caught by the Rule if:
  - the existence and material terms of the compensation arrangement are disclosed in any public document (such as the annual audited financial statements of the issuer or an annual filing made under any provision of Canadian securities legislation); or
  - the material terms of the compensation arrangement are set out in a written document, and the alteration
- to economic exposure or economic interest occurs as a result of the satisfaction of a pre-established condition or criteria described in the document, and does not involve a discrete investment decision by the insider;
- a person or company exempt from the insider reporting requirements under an exemption contained in Canadian securities legislation, to the same extent and on the same conditions as are applicable to such exemption;
- a person or company who has obtained exemptive relief in a jurisdiction from the insider reporting requirements of that jurisdiction, to the same extent and on the same conditions as are applicable to such exemptive relief;
- a transfer, pledge or encumbrance of securities by an insider for the purpose of giving collateral for a debt made in good faith so long as there is no limitation on the recourse available against the insider for any amount payable under such debt;
- the receipt by an insider of a transfer, pledge or encumbrance of securities of an issuer if the securities are transferred, pledged or encumbered as collateral for a debt under a written agreement and in the ordinary course of business of the insider;
- an insider, other than an insider that is an individual, that enters into, materially amends or terminates an agreement, arrangement or understanding which is in the nature of a credit derivative;
- a person or company who did not know and, in the exercise of reasonable diligence, could not have known of the alteration to economic exposure to the reporting issuer or economic interest in a security of the reporting issuer;
- the acquisition or disposition of a security of certain investment funds; or
- the acquisition or disposition of a security of an issuer which directly or indirectly holds securities of the reporting issuer if the insider is not a control person of the issuer and does not have or share investment control over the securities of the reporting issuer.

# Goodmans<sup>LLP</sup> Update

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The exemptions have been broadened as the last five exemptions were not contained in the draft Rule proposed in 2003.

Insiders of a reporting issuer who enter into derivative-based transactions, including equity monetization transactions, should be aware of the reporting requirements imposed by the Rule to ensure proper compliance and to avoid incurring late filing fees.

We invite you to contact any member of the Goodmans securities team to discuss any questions you may have regarding the insider reporting requirements.

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