TORYS

2015

CAPITAL MARKETS MID-YEAR REPORT

Torys explores the nexus of industry, commerce and regulation.

OVERVIEW

When the Bank of Canada governor warns that “the first quarter of 2015 will look atrocious” due to the oil shock and underscores “how uncertain the outlook is” for the Canadian economy, it would be fair to brace ourselves for a major slump in the Canadian capital markets. But despite these cautionary statements and the continuing volatility in energy prices, the Canadian capital markets appear to be keeping a steady pace. For the first quarter of 2015, there were 214 offerings completed in Canada raising an aggregate of approximately $83 billion in gross proceeds (compared to 277 deals in the first quarter of 2014 raising approximately $71 billion in gross proceeds).

But the confidence the market is demonstrating is tempered by recent history. With the economic and regulatory fallout of the ‘08 crash still in the rear-view mirror, scrutiny by many players remains fixed on proper oversight. In this year’s report, we discuss two important regulatory developments impacting North American capital markets—in the U.S., the recent clampdown on leveraged lending is leading to significant changes in the debt markets, and in Canada, we are seeing a continued focus on insider trading enforcement and the adoption of whistleblower initiatives.

Against this backdrop of heightened regulation and uncertain macro-economic factors, issuers and investors are responding to the current climate with inventive solutions. Participants in the mining industry, who have been hard hit by volatility in commodity prices, are using creative financing solutions where more conventional financing resources are unavailable. Cash-strapped governments are partnering with institutional investors with access to large capital pools to form public-private partnerships as an effective model to meet the growing demand in the infrastructure space. And Canadian, U.S. and foreign issuers publicly listed in the U.S. are successfully tapping into the robust U.S. capital markets through confidentially marketed public offerings.

This year’s report also features an analysis of how Canadian public companies have been responding to the new disclosure requirements regarding the representation of women in board and executive officer positions. Ultimately, these rules are designed to drive the development of a market standard that will lead to the advancement of gender equality in the C-Suite. If investors buy into the premise that companies with stronger female representation at the board and senior management levels perform better, issuers may start building diversity objectives into broader strategies to improve their long-term performance.

To discuss any of the issues in this report, please contact the authors.

Recent Work

RELIANCE

US$375M

144A/REG.S
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US$1B

IPO AND EQUITY OFFERING

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C$919M

COMPLEX DEBT RESTRUCTURING

SEARS HOLDINGS

US$380M

RIGHTS OFFERING IN SEARS CANADA

OUR EXPERTISE

Torys is recognized for its leadership in capital markets, with comprehensive expertise across all sectors and strong relationships with securities regulators and stock exchanges in Canada and the U.S. Our clients include many significant public and private companies; all of the major investment banks in Canada, the United States and internationally; major Canadian, U.S. and foreign investors; significant investment funds; and government agencies.

GETTING DEALS DONE

Legal counsel in the capital markets demands custom-fit advice to anticipate roadblocks and seize opportunities. Our clients count on us for seasoned, practical advice that is above all else, uniquely tailored to their objectives. We offer high-quality coordinated services in Canada and the U.S. through our Toronto, New York, Calgary, Montréal offices and through the strategic support of our Legal Services Centre in Halifax.

#1

Ranked Band 1 by Chambers and Partners

$44 BILLION IN DEALS

TORYS' CAPITAL MARKETS PRACTICE

BY THE NUMBERS: 2014 - PRESENT

$34 BILLION
in public offerings

This year, we advised our issuer and underwriter clients on a range of public offerings, including IPOs, registered shelf, follow-on and secondary offerings.

$17 BILLION
in cross-border offerings

A substantial amount of our work for clients has involved the expertise of our cross-border Canada/U.S. practice.

8 IPOs
worth $3.3 billion

Our recent IPO work includes helping clients in a range of industries go public, including in retail, life sciences, financial services, and REITs.

195
CAPITAL MARKETS
LAWYERS

Our team has significant and diverse expertise that spans practice areas, sectors and jurisdictions.

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DEVELOPMENTS IN INSIDER TRADING ENFORCEMENT

John Fabello, Rebecca Wise

Observers of our capital markets frequently comment on the problem of insider trading, especially in connection with takeover bids and other merger and acquisition transactions: “the most controversial feature of take-over bid transactions in recent years has been centered on the allegations made in the press and elsewhere that such transactions have led to ‘insider trading’ profits, benefitting directors and other insiders.”

That statement about insider trading could have been made about any number of recent high-profile cases in Canada, and while it was made by the authors of the Kimber Report, published 50 years ago, it expresses a perennial concern of securities regulators with detecting and prosecuting insider trading. In Ontario, recent high-profile decisions of the Ontario Securities Commission (OSC), legislative reforms and enforcement initiatives, some of which are discussed below, reflect a significant focus on illicit market activity.

Closing the Gap on Insider Trading

Ontario's *Securities Act* (the Act) prohibits a person in a "special relationship with a reporting issuer" from trading the securities of that reporting issuer with knowledge of material information that has not been generally disclosed. Over the last several years, the legislature has proposed various amendments to the Act aimed at closing gaps identified in the insider trading rules, demonstrating a legislative intent to tighten the regulation of insider trading. Where the legislature has not yet cured perceived defects in the Act, the OSC has increasingly used its public interest jurisdiction to do so.

Expanded Definition of Insider Trading to Capture All "Issuers"

The 2015 Ontario Budget proposes to expand the insider trading rules in the Act to apply not only to those with a special relationship with a "reporting issuer" in Ontario, but also to those with a special relationship with any other issuer whose securities are publicly traded.

This expanded application of the insider trading rules is intended to close the gap identified in the OSC's decision in *Re Suman*.[1] In *Re Suman*, employee Shane Suman had become aware that his employer was proposing to acquire a U.S.-based corporation and proceeded to purchase shares of the U.S. target corporation. As the U.S. target corporation was not a "reporting issuer," there was no technical breach of the insider trading rules. Notwithstanding the absence of a technical breach, the OSC engaged its public interest jurisdiction to make an order against the respondent, thereby in effect applying insider trading principles to an issuer not captured by the insider trading rules. A similar outcome was reached in the settlement agreement negotiated in *Re Hariharan*, which was approved earlier this year by the OSC.[2]

Definition of "Special Relationship"

In 2013, the Act's definition of "special relationship" was expanded to capture insiders, affiliates or associates of a company that is "considering, evaluating or

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[1] (2012), 35 O.S.C.B. 2809

[2] (2015), 38 O.S.C.B. 3356, 3373. As in *Re Suman*, the company in issue was not a "reporting issuer" as defined by the Act. The settlement included a finding that the respondent's conduct was contrary to the public interest, despite the absence of a technical breach.

proposing" to make a takeover bid for or engage in a business combination with a reporting issuer or to acquire a substantial portion of a reporting issuer's property. Prior to this amendment, insiders, affiliates and associates of a company were only considered to be in a special relationship where the company was "proposing" to engage in these actions.

These changes were intended to close the gap in the insider trading rules identified in the OSC's decision in *Re Donald*.[3] In *Re Donald*, the OSC concluded that Paul Donald, an officer of a public company who traded in securities of a company he knew to be a potential target of his employer, had not violated the insider trading rules because he was not in a "special relationship" (as it was then defined) with a reporting issuer. Although Donald's employer was actively considering the potential transaction, because his employer had not formally determined that it would "propose" to make a bid, Donald was held not to be in a special relationship with a reporting issuer. Again, notwithstanding the absence of a technical breach, the OSC engaged its public interest jurisdiction to make an order against the respondent.

A timely deal made just before a public announcement is one example of the "mosaic of circumstantial evidence" that the OSC has used to describe the broad range of evidence that can help prove insider trading.

Use of the Public Interest Jurisdiction

Under the Act, the OSC can make an order in the public interest even where there has been no technical breach of securities laws. Increasingly, the OSC has used its public interest jurisdiction to capture problematic trading activities that fall outside statutory prohibitions but which are nonetheless perceived to be contrary to the spirit of the insider trading rules in the Act.

Before the legislature amended the definition of "special relationship" and proposed an expanded application of the insider trading rules in the Act, the OSC had used its public interest jurisdiction to make orders against the respondents in *Re Donald*, *Re Suman* and *Re Hariharan*, despite the absence of a technical breach of the Act.

The settlement approved in *Re Moore* further demonstrates the OSC's tendency to engage its public interest jurisdiction to capture problematic trading activities. In that case, the respondent, an experienced investment banker, was able to

[3] (2012), 35 O.S.C.B. 7383

anticipate a merger transaction based on his special expertise (such that there was no "materially undisclosed fact"). The respondent settled on the basis that this was contrary to the public interest even if the insider trading rules themselves were not breached.

More recently, in *Re Finkelstein*, the OSC engaged its public interest jurisdiction to make an order against brokers who had recommended that clients purchase securities of a company in relation to which the brokers had material undisclosed information. Under the Act, it is not an offence for a person in a special relationship with an issuer and with knowledge of material undisclosed information to recommend or encourage another to trade.[4] Rather, the Act limits tipping to or informing others of the material undisclosed information. Despite the absence of a technical breach of the Act, the OSC found that the brokers had acted contrary to the public interest.

A trade representing a large percentage of a portfolio is an example of evidence used to help prove insider trading.

However, while the OSC has demonstrated its willingness to use its public interest jurisdiction to close perceived gaps in the Act, it has shown restraint in cases where the respondents in issue are not market participants. In *Re Baffinland*, the OSC concluded that its public interest jurisdiction was not engaged by the respondent's conduct because the respondent was a consultant, and not a director or officer of the company in issue and as such was not required to exercise its public interest jurisdiction.

Reliance on Circumstantial Evidence

Proving insider trading is difficult. While it is not difficult to demonstrate that a person traded, it is challenging to demonstrate that she or he possessed undisclosed material information when the trades occurred. It is often necessary to rely on circumstantial evidence from which reasonable inferences of an individual's knowledge of undisclosed material information can be made.

In *Re Finkelstein* the OSC explained that a variety of types of circumstantial evidence can be the indicia of insider trading, including: unusual trading patterns; a timely transaction in a stock shortly before a significant public announcement; a first-time purchase of the stock; an abnormal concentration of trading by one brokerage firm or with one or a few brokers; and a trade that represents a very significant percentage of the particular portfolio. These indicia are not exhaustive, and do not each need to be established in every case. In every case, "insider trading and tipping cases are established by a mosaic of circumstantial evidence which, when considered as a whole, leads to the inference that it is more likely than not that the trader, tipper or tipee possessed or communicated material non-public information."[5]

[4] (2014), 37 O.S.C.B. 8007

[5] *Re Finkelstein*, para. 47.

OSC Whistleblower Program and Other Initiatives

The OSC has developed new initiatives aimed at increasing the number of prosecutions and improving the speed and efficiency with which enforcement matters are resolved. Although not specific to insider trading, these initiatives will be important tools for the OSC in the prosecution of insider trading matters.

In February 2015, the OSC released OSC Staff Consultation Paper 15-401, which proposes the development of a whistleblower program at the OSC. The program, which is the first of its kind among Canadian securities regulators, would encourage the reporting of serious misconduct of Ontario securities law by offering a financial incentive to whistleblowers. More specifically, a whistleblower would be eligible to receive up to 15% of the total monetary sanctions ultimately ordered against the respondent as long as the information provided by the whistleblower was provided voluntarily, of high quality and original in nature and the monetary sanction against or settlement payment by the respondent exceeds $1 million. A whistleblower program may well lead to information about when an issuer's directors, officers and employees learned of material information, allowing the OSC to detect potential cases of insider trading.

A whistleblower would be eligible to receive up to 15% of the total monetary sanctions ultimately ordered against the respondent.

Other recent enforcement initiatives may also lead to the commencement and resolution of insider trading cases. In March 2015, the RCMP's securities investigation office (the Integrated Market Enforcement Team) moved into the OSC's offices, with a view to ensuring closer cooperation between the organizations, and in April 2015, the OSC announced the launch of a pilot mediation program, which will provide respondents involved in enforcement proceedings and OSC Staff the option of participating in a mediation to resolve the dispute.

Conclusion

Regulators have long sought to appropriately address insider trading. As recent developments demonstrate, bodies like the OSC are continuing to prioritize fostering and enforcing a healthy trading environment as regulation, market practices—and insider trading tactics—evolve.

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NEW RULES, NEW OPPORTUNITIES: LEVERAGED LENDING IN THE U.S.

Darien Leung, Jon Wiener

Leveraged lending in the U.S. fell to a three-year low of 57% in the first quarter of 2015 compared to first quarter of 2014.[1] After much speculation in the last two years, it appears that the U.S. interagency guidance on leveraged lending (the Guidance) issued in March 2013 by the Office of the Comptroller of the Currency (the OCC), the Board of Governors of the Federal Reserve System (the Federal Reserve) and the Federal Deposit Insurance Corporation (FDIC) is having a real effect on the U.S. debt markets.

When released, the Guidance was generally expected to have a moderate impact; today, the realized effects of the Guidance include a significant drop in overall volume of leveraged loans, and more specifically, a decrease in leverage ratios, most recently averaging 6.55 times in 2014 and reportedly down to 5.91 times in the first quarter of 2015.

57%

Decrease in leveraged lending in Q1 2015.

The Guidance applies only to leveraged loans and to those institutions regulated by the OCC, the Federal Reserve and the FDIC. Does this mean that there will be greater opportunity for non-bank institutions and sources of liquidity from outside of the U.S., including Canada? We believe the answer is a resounding yes.

What are the Types of Leveraged Loans That Pose Concern Under the Guidance?

In response to the financial crisis in 2007, U.S. regulators sought to address perceived deficiencies in underwriting standards and risk management by issuing the Guidance in conjunction with more frequent reviews of financial institutions. In their reviews, regulators examine internal standards and categorize lending portfolios. Financial institutions are expected to formulate their own definitions of what constitutes a leveraged loan, but four common transaction characteristics are identified in the Guidance:

- total leverage in excess of four times, or senior leverage in excess of three times;
- debt incurred for buyout, acquisition or distributions on capital;
- the borrower's debt-to-net-worth ratio is such that it is recognized as highly leveraged; and
- the borrower's post-financing leverage exceeds industry norms based on debt ratios or industry standards.

A transaction need not meet all four characteristics to be deemed a leveraged loan subject to the Guidance. Underwritten commitments to extend a loan are also governed by the Guidance.

Regulators assign leveraged loans a risk rating of "pass," "special mention," "substandard" or "doubtful." Although ambiguity still exists around the interpretation of the Guidance, certain transaction characteristics are viewed as earmarks of a loan that would be subject to criticism and include:

- leverage in excess of six times;

[1] According to a report issued by Thomson Reuters.

- the inability of the borrower to fully repay debt within five to seven years from cash flows; and
- an overreliance by the lender on borrower or sponsor projections, and difficult-to-determine EBITDA addbacks, such as unrealized cost savings.

It is widely expected the unregulated funds and institutions will step in to fill the gap in leveraged lending created by the new standards, resulting in new market dynamics for lenders and borrowers alike.

Loans without financial maintenance covenants (or covenant-lite loans) are not automatically problematic. Regulators will look at the lender's approach on due diligence, the sustainability of the borrower's capital structure and its ability to repay the debt.

Of course, there are no bright lines or safe harbours in the Guidance, so market players have been forced to proceed cautiously, and financial institutions are walking away from the more highly leveraged transactions. The Guidance appears to be having its intended effect of limiting higher-risk lending and ensuring that lenders apply more stringent diligence standards.

Opportunity For Other Lenders

It is widely expected that unregulated funds and institutions will step in to fill the gap in leveraged lending created by the new standards, resulting in new market dynamics for lenders and borrowers alike. According to Thomson Reuters PLC, the combined market share of Jefferies, Macquarie and KKR in the 2014 institutional new money loan league tables increased by 20%. We expect that pension funds and other entities not regulated by the OCC, the Federal Reserve or the FDIC will find opportunity here as well. Considering the absence of withholding tax on most loans from Canadian lenders to U.S. borrowers and their familiarity with U.S. loan structures and documentation, Canadian investors would seem well suited to benefit from the U.S. regulatory environment. With Canadian banks obviously subject to their own regulatory constraints, the biggest opportunity may fall to Canadian institutional investors such as pension plans, life insurance companies and private equity funds.

Acquirors may also increasingly rely on issuances of high-yield bonds in the U.S. and Canadian capital markets to finance leveraged acquisitions. The main downside to buyers and sellers is that the high-yield bond market has historically been more volatile than the bank market so sellers (at least in auctions) have generally required back-stop bridge commitments to support bids. The bridge commitments have traditionally been provided by banks subject to the Guidance, so the Guidance will likely chill the bridge commitment market as well.

Conclusion

Both the regulations and the market's reaction are very much in flux, but as the market shifts, we predict that new opportunities in the area of leveraged lending will emerge.

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WOMEN IN THE C-SUITE: CAN SECURITIES LAW ADVANCE GENDER EQUALITY?

Rima Ramchandani, Glen Johnson, Michele Cousens

Securities regulators around the globe have been focused on the underrepresentation of women in the C-Suite. Most notably, the United States, United Kingdom and Australia require disclosure of diversity practices and board nomination and selection procedures. At the direction of the Ontario provincial government, the Ontario Securities Commission (OSC) launched a public consultation process in 2013 to explore a model of disclosure intended to advance gender diversity on boards and in senior management.

In December 2014, the OSC (along with every other Canadian jurisdiction, except Alberta, British Columbia and the Yukon) introduced new disclosure requirements relating to women on boards and in executive officer positions.

Overview of Our Survey

To spotlight the impact of the new rules and emerging disclosure trends, we reviewed the proxy circulars of all reporting issuers in the S&P/TSX Composite Index subject to the new rules whose circulars were filed by May 10, 2015. These 179 reporting issuers make up approximately 71% of the Index and have an average market capitalization of approximately C$8.3 billion.

Most of Canada's largest financial institutions were excluded from our survey group because, due to their fiscal years, they will not be subject to the new disclosure rules until next year. These institutions have historically been early adopters of corporate governance best practices, and often lead the way in the development of market standards for good governance. To compare their practices with the issuers in our survey group, we also reviewed the proxy circulars of nine of Canada's largest financial institutions.

Adoption of Policies

56% of the 179 issuers in our survey group have adopted formal policies addressing the representation of women on the board. This is a good example of disclosure rules driving corporate behaviour, as the vast majority of issuers who have policies appear to have adopted them between the 2014 and 2015 meeting seasons. While the rules only require disclosure regarding board policies, some issuers have gone further and adopted a policy that also addresses women's representation in senior management (either as part of the board policy, or as a standalone policy).

Figure 1. Prevalence of Policies

Survey Group

56%	44%
With Policies	Without Policies

Recap of New Disclosure Rules

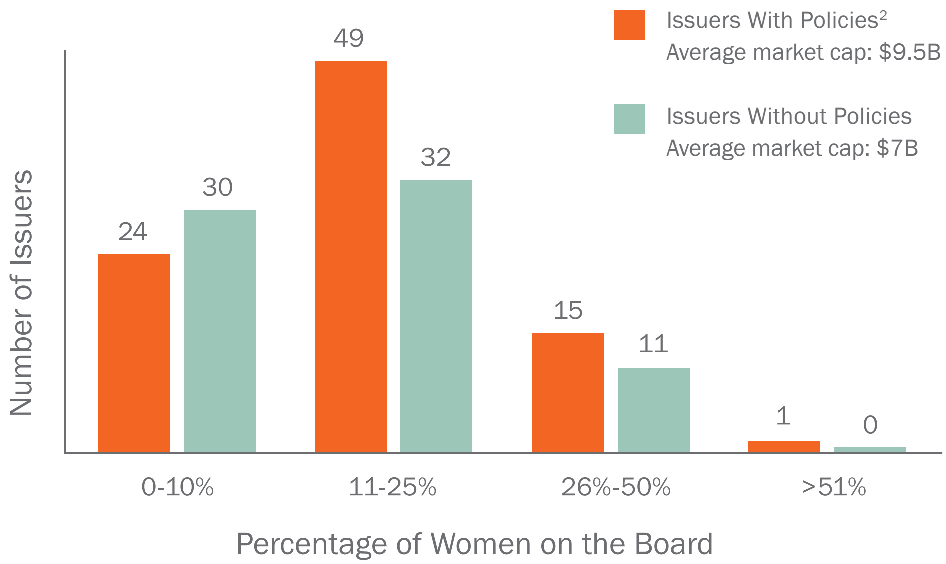
The new rules follow Canada's "comply or explain" model of corporate governance and require issuers[1] to disclose:

- how many directors and executive officers are women;
- whether they have a written policy relating to women directors (or if not, why not); and its key provisions;
- whether and how the representation of women is considered in board and executive officer appointments (or if not, why not); and
- any targets adopted (or if not, why not) and progress in achieving them.

[1] This excludes venture issuers, investment funds and issuers reporting only in Alberta, BC and the Yukon.

We found that issuers with policies tended to have larger market capitalizations and, perhaps not surprisingly, more women on their boards. Consistent with this, 7 of 9, or 77% of the Canadian financial institutions we looked at have board diversity policies in place and their boards are comprised of 34% women on average, compared to 16.4% women on average among all issuers in our survey group.

Figure 2. Number of Women on Boards



Scope of Policies and Targets

Jim Leech, former President and CEO of Ontario Teachers' Pension Plan, remarked in a roundtable discussion during the consultation process that "[d]iversity is experience, is nationality, is ethnicity and gender—[but] gender just jumps off the page at you. Fifty percent of the population and fifty percent of the board. . . it just jumps off the page, and I guess we're going to eat this elephant one bite at a time."[3] The new rules align with this sentiment by focusing exclusively on policies regarding the representation of women (and not other groups) on boards and in senior management.

Despite the rules being focused on the representation of women, within our survey group a substantial number of issuers opted to adopt broader diversity policies. 60% of the policies we reviewed referred to the importance of diversity more generally,

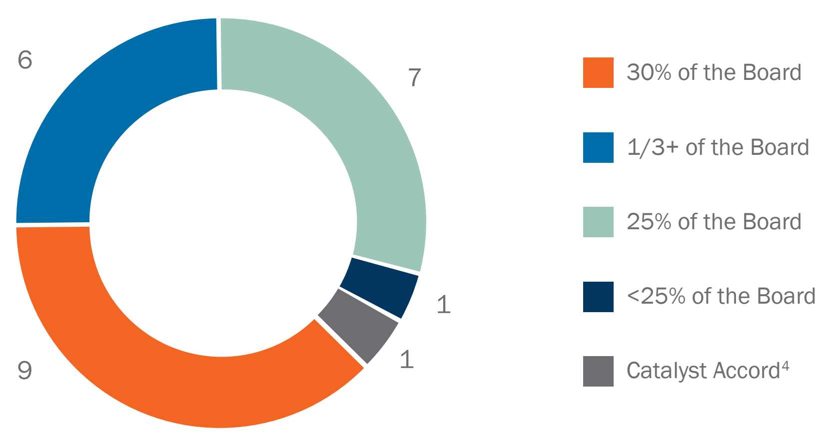
[2] Where issuers were silent, we assumed that they do not have a policy regarding the representation of women on the board.

[3] Transcript of the roundtable discussion of OSC Staff Consultation Paper 58-401 Disclosure Requirements Regarding Women on Boards and in Senior Management on October 16, 2013. Available at: http://www.osc.gov.on.ca/documents/en/Securities-Category5/oth_20131016_58-401_transcript.pdf

including, among other factors, diversity of race, nationality, ethnicity, religion, aboriginal identity, age, disability, sexual orientation and, of course, gender. We expect this is reflective, in part, of the broader scope of many issuers' existing non-discrimination and employment equity policies, which may have served as a point of reference for their policy regarding the representation of women.

Only a small subset of issuers in our survey—24, or 13%—have taken the step of adopting objective, measurable targets. Moreover, with a single exception, all quantifiable targets that issuers have set relate solely to the representation of women (and not other under-represented groups) on the board. Interestingly, four issuers applied the targets only to the independent directors—this approach may appeal to issuers with controlling shareholders or other groups with board nomination rights who do not want to be constrained by the consideration of diversity when selecting their board nominees. We also found that most issuers who have committed themselves to targets have already met those targets—signaling perhaps a reluctance to adopt targets that may not be achievable, especially in light of the obligation to measure progress against targets in future disclosures.

Figure 3. Targets Set for the Representation of Women on Boards



A commitment to selecting candidates based on merit was by far the most common reason issuers gave for not having a policy about the representation of women on the board, not considering gender in the board nomination process and/or not adopting a target for female board representation. On the next page is a breakdown of the most common reasons cited.

[4] Companies that sign the Catalyst Accord pledge to increase the percentage of women on their boards by 2017. The Catalyst Accord calls on Canadian corporations to increase the overall proportion of FP500 board seats held by women to 25% by 2017. The FP500 is a definitive ranking of Canada's largest companies by revenue.

Figure 4. Reasons For Not Having a Policy, Not Considering Gender or Not Adopting Targets

Reason Given	Number of Issuers[5]
Board candidates are selected based on merit	86
No reasons disclosed	32
Would not be in issuer's/shareholders' best interests	17
Would reduce board's flexibility/unduly restrictive	16
Targets would not be effective/are arbitrary	16
Level of diversity is already adequate	10
Want to select candidates from broadest talent pool	8
Industry is male-dominated/talent pool is too small	5
Currently under consideration	2

Women Executive Officers

Issuers are approaching the disclosure requirements regarding women executive officers in many different ways. Although the new rules call for disclosure about "executive officers" as defined in National Instrument 51-102, nearly one quarter of issuers in our survey group chose to disclose statistics covering more than executive officer positions, and the extent of overlap between the individuals included in the statistics disclosed and the executive officer group was often unclear. For instance, issuers disclosed female representation on an aggregated basis within senior management, executive leadership, senior officers, "named executive officers," officers, managers, senior VPs, VPs and the workforce as a whole.

[5] The total in this column is greater than our survey size of 179 issuers because some issuers gave more than one reason.

Some issuers may have tailored their disclosure to demonstrate that, while the representation of women in executive officer positions may currently be low, a robust pipeline of women with opportunities for internal promotion at different levels of management exists. We also suspect that some issuers provided disclosure of the segment of their workforce with the most balanced gender make-up.

Among the 132 issuers, or 74% of our survey group, who clearly disclosed how many women they have in executive officer positions, the average was 24%—this is the same as the average of female executive officers at the large Canadian financial institutions whose circulars we reviewed. This stands in contrast to the sizeable discrepancy in female board representation between the financial institutions (whose boards are comprised of, on average, 34% women) and our survey group (whose boards are comprised of, on average, 16.4% women).

Only a very small group (five companies) have adopted numerical targets for women in any of the executive or management categories mentioned above. The reasons given for not adopting targets mirror the reasons given in the board context—primarily the desire to focus on qualifications, skills and other merit-based characteristics.

Key Takeaways:

The new disclosure requirements—and issuers' initial responses this year—bring to the forefront a number of considerations for Canadian reporting issuers.

Walking the Talk...

This year, many issuers responded to the new disclosure rules by adopting a policy regarding the representation of women on the board. The next challenge will be to effectively implement these policies in a meaningful way. Although most policies do not set fixed objectives, the new disclosure requirements have been effective at kick-starting the dialogue about women in the C-Suite among boards, governance and nominating committees and other market participants.

...One Step at a Time

The new rules were designed to address the discrete issue of underrepresentation of women in board and executive officer positions. The importance of diversity and inclusiveness more generally is reflected in many issuers' policies which, laudably, are not limited to gender diversity, and this could ultimately lead to progress for other underrepresented groups. However, as noted earlier, "gender jumps off the page," and we believe that securities regulators chose to focus on gender as an important first step.

Formal Targets are Unpopular

Many issuers expressed a resistance to targets on principle. Particularly in the executive officer context, where the talent pool or succession pipeline may be predominantly male or where recruiting externally is antithetical to the corporate culture, we believe that the adoption of targets will continue to be rare.

Targets—or Caps?

Where targets are adopted, they may inadvertently serve as caps for female representation in board and executive officer positions. It would be unfortunate if adopting targets worked to undermine an issuer's ability to achieve a longer-term objective of gender parity.

Addressing Barriers to Change

While eschewing targets, some issuers may look for other ways to increase the representation of women, and advance diversity more broadly, among their senior management team. Issuers may focus on systemic ways of building the pipeline of potential future women executive officers, for example, by making changes to their recruiting strategies, granting scholarships, and enhancing their internal retention and mentoring programs.

[*] To provide full disclosure, as of December 2014, 22% of Torys' partners and 35% of the firm's lawyers are women.

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TAPPING U.S. MARKETS: CONFIDENTIALLY MARKETED PUBLIC OFFERINGS

Mile Kurta, Cheryl Reicin, Erin Wiley

For companies seeking to raise capital in the United States, volatile market conditions can prove to be challenging. One common method issuers use to mitigate this volatility in the Canadian markets is a bought deal, whereby the market risk is shifted from the issuer to the underwriter. However, not all issuers, especially those whose stock is thinly traded, are able to raise capital through a bought deal.

One attractive alternative for Canadian, United States or other foreign issuers publicly listed in the U.S. is to conduct a confidentially marketed public offering (CMPO). CMPOs provide issuers and underwriters with flexibility to gauge market interest on a confidential basis prior to making a deal public. For the right issuer, CMPOs can be an effective alternative to the more conventional marketed underwritten public offering.

Why Conduct a CMPO?

There are a number of benefits to conducting a CMPO:

- it allows issuers and underwriters to gauge market interest for a particular offering prior to making a deal public, thus avoiding the negative impact of a failed public offering should the confidential marketing not be successful; and
- because the public marketing period is conducted over a relatively short period of time (generally on an overnight basis), a CMPO may help an issuer avoid downward pressure on its stock price between the public announcement and the pricing of the offering.

How is a CMPO Typically Structured?

The deal timeline for a CMPO can be subdivided into a series of distinct phases.

Phase 1

Phase 1 looks very similar to a standard underwritten deal. Offering documents, including the prospectus supplement, underwriting agreement and opinions of counsel, will be prepared and negotiated, and underwriters will perform due diligence, including preparation of the auditor comfort letter.

Phase 2

During Phase 2, the underwriters will market the deal on a confidential basis to a targeted group of sophisticated investors. Once the underwriters are confident that there is enough interest in the offering, the deal will be "flipped" to public in Phase 3.

Phase 3

This typically takes place after the markets close on the day the offering is formally launched. At that time, the preliminary prospectus supplement is filed with the Securities and Exchange Commission (the SEC) and the public offering is announced. During this public marketing phase, the underwriters will continue to market the securities on an expedited (usually overnight) basis to a broader group of investors.

Phase 4

The deal will generally be priced the following morning before the markets open in Phase 4, but sometimes a longer public marketing period is required. At pricing, the underwriting agreement is executed and the auditor comfort letter is delivered, and subsequently the final prospectus supplement is filed with pricing terms.

Phase 5

Finally, Phase 5 is the period from pricing to closing and is conducted in the same way as closings for standard underwritten public offerings.

CMPOs are largely marketed using existing public disclosure and a "bare-bones" prospectus supplement, thereby eliminating the costs and delays associated with lengthy drafting sessions.

To conduct a CMPO, an issuer must have an effective shelf registration statement on file with the SEC (typically Form S-3 for U.S. companies, Form F-10 for MJDS-eligible Canadian companies and Form F-3 for other non-U.S. foreign private issuers).

CMPOs are generally more time and cost efficient for issuers than conventionally marketed deals because the offering is largely marketed using existing public disclosure and a "bare-bones" prospectus supplement, thereby eliminating the costs and delays associated with lengthy drafting sessions.

How Does the Confidential Marketing Period Work?

The confidential marketing period that defines CMPOs results in a particular focus for issuers and underwriters on ensuring compliance with selective disclosure issues and rules related to trading on the basis of material non-public information.

Bringing Investors "Over the Wall"

Before the confidential marketing period begins, underwriters will initiate communication with targeted sophisticated investors. This is usually done orally and via a script that has been pre-approved by both issuer and underwriter counsel. This initial solicitation gives notice to the targeted investors of a potential offering, but does not provide them with any specific details, such as the issuer's identity, prior to obtaining certain confidentiality and other undertakings from the investors. These undertakings are typically obtained orally during the initial solicitation, followed by confirmation of the undertakings via email, and will often prohibit the investors from trading for a certain period of time. This is done (i) to ensure that investors that have been "brought over the wall" during the confidential marketing period do not trade on material non-public information and (ii) to deal with other selective disclosure concerns. In addition to the above procedure, some underwriters also require their investor base to sign general confidentiality agreements that apply to any CMPO that will come to an investor's attention in order to avoid the delay associated with attempting to obtain signed agreements once a CMPO has been initiated.

"Cleansing" Statements

Potential investors that are solicited during the confidential marketing period may require that an issuer make a "cleansing" statement to make public any material non-public information provided to investors during the confidential marketing period if the offering does not proceed within a specified period of time. In the case of such a request, the issuer will enter into a written agreement with the underwriters, committing to make such a "cleansing" statement if the offering does not proceed. The underwriters, however, generally only use marketing materials that are based on information that is otherwise publicly available so as to avoid the need to file any of the non-public information publicly if the offering does not proceed.

What Other Key Issues Arise During CMPOs?

Given that one of the goals of a CMPO is to get to market on an expedited basis, special care must be taken to ensure that every issue is fully considered in advance of the launch of the transaction.

Preparation of Documentation

Because the length of the confidential marketing period is unknown, it is important to have all documentation negotiated and finalized prior to commencing any marketing efforts. The reason for this is so that the offering can be "flipped" to public very quickly to avoid losing any momentum in the book-building of the deal. This includes the prospectus supplement, underwriting agreement, opinions and comfort letters. It is also important to finalize all material due diligence items prior to the confidential marketing.

FINRA

A shelf takedown, regardless of whether it is a CMPO or not, generally has to receive Financial Industry Regulatory Authority (FINRA) clearance (subject to certain exceptions). FINRA has a review and clearance process that allows for receipt of FINRA clearance the same day that the application is submitted, which is particularly useful in the context of the CMPO's expedited timeline. It is important to ensure that the base shelf was pre-cleared with FINRA prior to the commencement of the offering to avoid any delays.

Shelf Capacity

Prior to undertaking the confidential marketing, issuers must also be mindful of whether the contemplated offering size (or any potential upsize if market conditions are favourable) is permitted based on the capacity available under their shelf registration statement.

Material Information

Issuers and underwriters should consider any material information that may be disclosed in the imminent future. Earnings results, acquisitions and other events could make marketing difficult or require further disclosure than what is in the public record.

Dual-listed Companies

For issuers that have securities listed on a non-U.S. exchange (such as the Toronto Stock Exchange) in addition to a U.S. listing, it is particularly important to coordinate with both the relevant U.S. and non-U.S. exchanges to ensure that there are no trading-related issues for the issuer's securities in connection with the CMPO. In general, the laws of the non-U.S. jurisdiction must be examined to ensure that the CMPO procedures comport with local law.

With respect to securities listed on an exchange in a jurisdiction that is in a different time zone, an issuer may need to work with that exchange to halt trading of those securities from the time that the deal is made public to the time when the underwriters confirm orders with investors. Since the marketing period will generally take place when the markets are closed in the United States, both issuers and underwriters want to avoid any significant price fluctuations of the securities on a foreign exchange during that time.

Conclusion

For the right issuer, CMPOs can be a useful alternative to the standard underwritten public offering. U.S., Canadian and foreign companies with effective shelf registration statements on file with the SEC should keep CMPOs in mind as another potential way to access the U.S. capital markets.

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FINANCING IN THE MINING SECTOR: CREATIVE SOLUTIONS GO MAINSTREAM

Michael Amm, Michael Pickersgill, Peter Danner

As challenging financing markets persist in the mining sector, miners are increasingly looking to creative combinations of financing options to fund project development and acquisitions. It is now common for transactions to feature multiple financing sources, with both equity (public and/or private) and debt (senior secured, high-yield, convertible and/or cost-overrun facilities) being raised in conjunction with streaming, off-take and/or royalty financing.

No longer confined to junior and mid-tier transactions, stream and royalty financing is playing a key role in high-profile transactions. With their sustained use, streams and royalties are evolving to suit the needs of mining companies and their financiers.

Evolution of Stream and Royalty Financing

Streams and royalties can be highly flexible instruments. Although used for some time in the mining sector, more recently they have been used in conjunction with traditional debt and equity to bridge the funding gap for both project development and M&A transactions. Streams are also used by miners as an alternative to non-core assets sales, whereby the miner completes a forward-sale of by-products from a mine (usually precious metals) while retaining control over its mining operations.

As the use of stream and royalty financing becomes more frequent, these instruments are being tailored to align with the needs of transaction parties. Recent transactions have included some of the following features:

- a combination of fixed and floating delivery schedules;
- the linkage of streamed precious metal deliveries to underlying base metal production;
- multiple buyers and third-party information/paying agents and security trustees involved in syndicated stream arrangements;
- coverage of new products and minerals, such as diamonds and chromite; new variations on traditional royalty calculations to extract downstream value; and
- the use of "early deposit" stream structures to fund pre-development stage projects.

Royalties have also featured in prominent spin-off transactions as an important means of ongoing financing for the "spinco" entity.

Inter-creditor issues are a key part of negotiating transactions involving multiple financing sources. Royalties and streams give rise to unique inter-creditor considerations as the interests of royalty holders and stream financiers often conflict with those of traditional creditors in an enforcement scenario. These and related issues are fundamental to the various financing parties and should be addressed as early as possible in the transaction process, whether the stream or royalty is implemented in conjunction with existing or new credit facilities, or in advance of other project financing that will be required.

Entry of New Participants

Major royalty and stream companies, such as Franco-Nevada, Silver Wheaton and Royal Gold, continue to be the primary players in this area. New participants, such as major pension funds, other institutional investors and mining-focused private equity firms, are becoming increasingly active. For example, La Caisse de dépôt et placement du Québec (La Caisse) agreed to provide C$275 million stream financing in connection with the proposed partnership between Osisko Mining and Yamana Gold as an alternative to Goldcorp's original hostile bid for Osisko. La Caisse also partnered with the Orion Mine Finance Group, a mining-focused private-equity investment business, to provide C$250 million stream financing to Stornoway Diamond Corporation in connection with the construction of the Renard diamond project. The Renard stream was recently further syndicated through the secondary sale of a minority interest in the stream to a Blackstone affiliate. As access to traditional equity and debt financing remains constrained, we expect to see a growing number of new players enter this space and continue to focus more attention to these opportunities.

Streams and royalties can be highly flexible instruments; more recently they have been used in conjunction with traditional debt and equity.

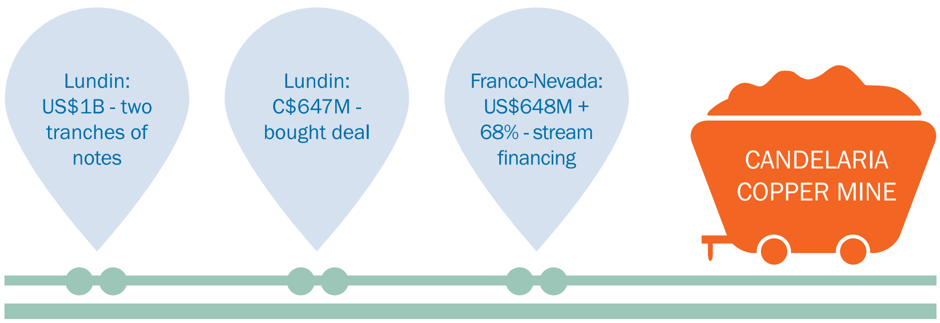
Recent Transactions

Several recent high-profile examples showcase the sector's new wave of multifaceted financing packages for project development and M&A transactions.

In July 2014, Stornoway completed a C$944 million comprehensive financing package for the construction of its Renard diamond project in northern Québec. The various financing transactions, which involved a marketed offering of common share subscription receipts in conjunction with the negotiation of five different financing facilities with four different financing parties, taken together, constituted the single largest project financing transaction for a publicly listed diamond company. The financing package consisted of a combination of public and private equity financing, separate senior secured debt, convertible debt, cost overrun and equipment financing facilities and a US$250 million diamond stream financing. Orion and La Caisse provided a first-of-its-kind stream financing based on diamond production, designed to allow further syndication of the stream. The application of the stream vehicle to diamonds, a non-fungible product, required innovative structuring to achieve the parties' commercial, legal and tax goals.

Stream financing played a key role in Lundin Mining's US$1.8 billion acquisition of Freeport-McMoRan's 80% ownership stake in the Candelaria copper mine in Chile. The acquisition was funded with a combination of equity financing, senior secured debt and stream financing. Lundin raised US$1 billion through the sale of senior secured notes in two tranches, US$550 million of 7.5% Senior Secured Notes due 2020 and US$450 million of 7.875% Senior Secured Notes due 2022, and completed a C$674 million bought deal offering of common share subscription receipts. The stream financing was provided by Franco-Nevada and consisted of the sale of a stream on 68% (reducing to 40% after certain thresholds are met) of Candelaria's gold and silver production for an upfront payment of US$648 million. Franco-Nevada also participated in the equity financing for C$50 million.

Lundin Acquisition of Candelaria Copper Mine



Significant royalty financing was part of the recent acquisition by Noront Resources of Cliffs Natural Resources' chromite mining claims in Ontario's Ring of Fire mining district. To finance the acquisition, Noront entered into a loan agreement with Franco-Nevada through which Franco-Nevada loaned US$25 million to Noront for a five-year period at a 7% interest rate with interest to be accrued and paid at the end of the loan term. In return, Franco-Nevada received a 3% royalty over the Black Thor chromite deposit and a 2% royalty over most of Noront's remaining property in the region. In addition, Noront received US$3.5 million in cash consideration from Franco-Nevada as part of the granting of the royalty arrangements.

Conclusion

As conditions remain challenging in the mining sector, creative financing solutions will play an ongoing and key role in transactions in the mining sector. Streams and royalties will continue to evolve to meet the particular needs of mining companies and their financiers and attract new participants in the alternative financing space.

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INVESTING IN THE FUTURE: PPPS AND INFRASTRUCTURE ASSETS

Mark Bain, Tara Mackay

As global demand for improved infrastructure rises in tandem with institutional investors' need to invest large capital pools in long-term assets, allocations of private capital to public infrastructure, as an investment asset class, are set to grow significantly. The PPP model is one innovative strategy that is increasingly being deployed by governments and investors around the world to inject private capital into the asset class.

Infrastructure: A Growing Asset Class

Continuous investment in new and improved infrastructure is essential to ensure ongoing growth and prosperity around the world. In their 2013 report, *Infrastructure productivity: How to save $1 trillion a year*, the McKinsey Global Institute estimated that just to keep pace with projected global GDP growth, the world will require an additional $57 trillion in infrastructure investment by 2030, a 60% increase in the amount spent over the past two decades. Similarly, the World Economic Forum has reported that global spending on basic infrastructure (which includes transportation, water, power and communications infrastructure) currently amounts to $3 trillion instead of a recommended $4 trillion, creating a $1 trillion annual gap.

To address this burgeoning demand, governments struggling to balance their budgets must encourage private-capital investment in infrastructure. This shouldn't be a tough sell for institutional investors like pension funds, sovereign-wealth funds, and insurance companies, whose investment needs align well with infrastructure assets, which offer long-term and stable cash flows to offset long-term liabilities. These assets also often have built-in inflation protection, and their relative illiquidity compared to other asset classes may not be as big of an issue for institutional investors as it would be for other categories of investors.

Global spending on infrastructure: $3 trillion
Recommended amount: $4 trillion

ANNUAL GAP: $1 TRILLION

The OECD's December 2014 *Annual Survey of Large Pension Funds and Public Pension Reserve Funds* reported that the most salient trend in the survey population (comprised of 104 large pension funds and public pension reserve funds managing a combined US$10.4 trillion in assets) was an increase in alternative investments, including infrastructure. While the survey results show a low level of actual investment in infrastructure on average, there is huge potential demand with many funds increasing their allocation to infrastructure or opening new allocations to the infrastructure asset class. According to the report, target allocations among the funds with dedicated infrastructure exposure ranged on the low end from 1% to over 20% of total assets.

The PPP Model

The public-private partnership (PPP) procurement model is one way to use private capital to build public infrastructure. Although the PPP model means different things to different people, the Canadian Council for Public-Private Partnerships defines a

Amount needed to keep up with the global infrastructure demand by 2030.

PPP as “a cooperative venture between the public and private sectors, built on the expertise of each partner, that best meets clearly defined public needs through the appropriate allocation of resources, risks and rewards.”

A typical PPP transaction involves the selection by a public-sector entity of a private-sector partner to design, build, finance, operate and maintain a piece of public infrastructure for a term that spans several decades (usually in the range of 25 to 50 years). The transaction may be structured on an availability basis, where the private partner is paid for ensuring that the infrastructure is available to the public in a specified condition, or may include some revenue risk to the private partner, as would be the case with a toll road or bridge. The vast majority of PPP transactions in Canada are availability payment deals, and the availability payment model is also gaining popularity in the U.S.

The financing of a PPP transaction is characterized by high leverage—90% debt and 10% equity would be typical for an availability payment deal without unusual risk allocation—and low debt service coverage ratios, robust security packages from subcontractors to cover performance risks and, ideally, a strong government counterparty with the power to appropriate the funds necessary to pay for the asset over time.

Many Canadian PPP transactions involve large milestone payments from the public-sector partner to the private-sector partner on completion of construction—allowing for innovative financing structures.

Although some PPP transactions involve the refurbishment or repurposing of established assets (e.g., the creation of high-occupancy toll lanes on existing roadways), most are best described as “greenfield” in that they involve the creation of new assets needed to replace aging infrastructure or accommodate increased demands resulting from population growth or demographic shifts. In this way, PPP transactions create new assets to be bought and sold by investors in the future.

In Canada, many PPP transactions involve relatively large milestone payments from the public-sector partner to the private-sector partner on the substantial completion of construction. This allows for the use of innovative financing structures involving a combination of short-term bank and/or bond financing to cover the construction period, and long-term bond or private placement financing to cover the remainder of the operational term. In contrast, in the U.S., government support often takes the form of tax-advantaged debt financing products rather than milestone and completion payments.

Institutional Investors are Embracing PPPs in the Canadian Market

Most of the large Canadian life insurance companies, including Manulife, Canada Life and Sun Life, are active as debt investors in the PPP space. The Canadian pension funds also participate, primarily as equity investors; for example, Borealis Infrastructure, the direct infrastructure investment arm of OMERS (one of Canada's largest pension funds with approximately C$72 billion in net assets) has invested equity in several PPP transactions in Ontario.

It was also recently announced that La Caisse de dépôt et placement du Québec (La Caisse), which manages public pension plans in the province of Québec and has almost C$226 billion in net assets, will be given new powers to control and develop major infrastructure in the province. The Government of Québec will identify and approve potential projects and La Caisse will undertake the planning, financing and execution of the project on the government's behalf. At present, it appears that their approach will share some features with the PPP model, including a focus on the overall costs of a project over its entire lifecycle. Assuming that planned legislative amendments are passed later this year, La Caisse plans to establish a new subsidiary, CDPQ Infra, to execute the projects. The first two projects that have been identified, a public transit system on Montréal's new Champlain Bridge (which is currently being procured as a PPP project by the Canadian government) and a public transit system linking downtown Montréal to the Montréal-Trudeau International Airport, are expected to require a combined investment of approximately C$5 billion.

Conclusion

Whether through the PPP procurement model or other innovative strategies, governments at all levels and in jurisdictions around the world have come to recognize that they must encourage more private capital to participate in the development of our public infrastructure. At the same time, more and more institutional investors are looking for opportunities to put their capital to work in alternative assets classes. It seems inevitable that these complementary trends will converge sooner rather than later.

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Torys' Capital Markets Practice is recognized in Canada and internationally as a leader in its field. Torys has deep expertise across the range of capital markets transactions, including initial public offerings, follow-on offerings, high-yield and other debt offerings, subscription receipts, preferred shares and private placements, including private investment in public equities (PIPES). Torys' lawyers have strong relationships with securities regulators and stock exchanges in Canada and the U.S.

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