TORYS LLP

Capital Markets 2011 Mid-Year Report

Torys' Corporate and Capital Markets Practice

Our cross-border Corporate and Capital Markets Practice encompasses traditional and novel financing transactions in both domestic and international capital markets. We provide a broad range of services to clients in all major industrial sectors, and we have particular expertise acting as both lead transaction counsel and as a strategic adviser in structuring and implementing sophisticated, innovative financing transactions. We are regularly retained by governments and regulatory authorities to provide advice in developing and implementing major policy initiatives.

Our practice is highly ranked globally by various sources, including Bloomberg, Mergermarket, Thomson Reuters and *Lexpert* – not only for our lawyers' depth of knowledge and experience but also for their can-do approach and dedication to the highest-quality work. With our focus on advancing our clients' business and legal objectives with solutions that are most fitting to their circumstances and requirements, we are entrusted to advise on our clients' most significant transactions.

Torys is able to offer high-quality, coordinated and timely capital markets services in both Canada and the United States. And with the opening of our Calgary office earlier this year, we have enhanced our service to Canadian and international clients that are investing or conducting business in Alberta or in the energy sector overseas.

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Cover photo: *Green Apples, 1993* (detail), by Victor Cicansky/Mira Godard Gallery.

In 2009, Canadian-born Cicansky's contribution to the arts as a mentor, educator and sculptor was acknowledged when he was named a member of the Order of Canada.

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Overview

Capital Markets in 2011 in North America and Beyond

To date, 2011 has been an exciting year in North American capital markets. The owner of the Toronto Stock Exchange was put into play. Leading industry participants, including some of the big banks, not only advocated against its merger with the London Stock Exchange but joined forces to make a counterproposal to keep ownership of the TSX Canadian. At the same time, south of the border, the owner of the New York Stock Exchange agreed to merge with Germany's Deutsche Boerse. A rival bid by the Nasdaq OMX Group and Intercontinental Exchange was rejected as hollow, ill-defined and too risky from an antitrust perspective. At the time of printing, uncertainty exists as to whether a TSX merger will be completed and what the impact of these deals will be on financial services in North America and on the business of securities trading globally.

While the future of the TMX Group hangs in the balance, the Canadian market remains open for business in 2011. Over $1 billion worth of initial public offerings have been completed to date in 2011, with more in the pipeline for the second half of the year. Almost half of the new equity issued since the start of 2010 was for the resource sector, which has used the equity primarily for acquisitions and to fund capital expenditures. The real estate sector has also continued to be strong, capitalizing on its attractive yield relative to industrials and financial institutions.

In the United States, IPO activity has significantly increased in 2011 compared with the same period in 2010, with over US$8 billion raised to the end of June compared with US$2.7 billion in the first half of 2010. In contrast with Canada, the most notable industry sectors for U.S. IPOs so far this year have been technology and communications. Interest in companies in these sectors has generally been driven by strong recent and forecasted growth, but some commentators are raising concerns that a new technology sector bubble may be starting to form. Many of the IPOs are driven by private equity firms seeking liquidity for investments. Some of the more recent IPOs have been downsized, so we will watch to see how these companies fare over the remainder of the year.

In other markets, Glencore International's IPO was the biggest ever on the London Exchange, at over US$11 billion. Commentators have asked whether this offering marks the peak of the commodities cycle, with sophisticated investors leaving before the returns start to fall, or whether this simply demonstrates the need for sophisticated enterprises to access public markets in order to succeed. Given the importance of commodities to the Canadian resource sector and, by extension, the Canadian economy, we hope the latter is true.

Debt markets have been active in 2011, with over $40 billion worth of senior and subordinated bonds issued in Canada and US$655 billion in the United States. Notably, as we indicated in our *Capital Markets 2010 Mid-Year Report*, there is an active high-yield market in Canada, with over a dozen deals being done since mid-2010, and more in the pipeline. Like convertible debenture issues, which have also been popular in 2010 and 2011, high-yield debt appeals to investors who focus on yield and has been used to finance acquisitions.

As the year unfolds, we will watch the impact of Basel III on financial institutions and capital markets generally. We expect to see financial institutions involved in limited capital-raising activities in the near term. As we discussed in our *Capital Markets 2010 Mid-Year Report*, Canadian banks are well capitalized relative to their global colleagues, but the Canadian Office of the Superintendent of Financial Institutions will expect even more from them, even faster. We have not yet seen any banks take the plunge to raise contingent capital, but eventually their hands will be forced. Will Canadian markets be able to finance their banks or will the banks have to broaden their reach to find investors who are willing to buy the new capital at acceptable prices? Will banks pass on the costs of this new capital to their corporate and retail customers in Canada?

Torys' lawyers have been actively involved in these and other developments in the capital markets in 2011. In the pages that follow, we share with you what we have seen in 2011 and expect the rest of the year to bring. With our new office in Calgary, we will be even more active in the resource sector in the remainder of 2011 and beyond, and we look forward to working with you in Alberta and around the world.

July 2011

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Implications of the Basel III Rules

New requirements will have far-reaching effects for financial institutions

Blair Keefe

Capital market activities remained slow in the first half of 2011 and, in the absence of significant M&A transactions, are unlikely to pick up until sometime in 2012 or possibly 2013 or later.

This decreased activity has several causes.

As we noted in our 2010 report, with the high level of capital raising in 2008 and 2009, and conservative dividend and share buyback programs implemented during the financial crisis, the capital ratios of Canadian financial institutions are well above historical norms and the minimum requirements of the Office of the Superintendent of Financial Institutions (OSFI).

Moreover, on the international front, the Basel III Capital Rules have been finalized and are in the process of being implemented in Canada and in other jurisdictions, with a phase-in period starting in January 1, 2013, and full implementation required by January 1, 2019.[1] These new requirements will have major implications for future capital-raising activities of Canadian deposit-taking institutions.

First, the new rules require banks to hold significantly more common share equity in their capital structure and impose more deductions in the calculation of what is considered available common share equity. For example, previously non-controlling substantial investments in banks or securities dealers and investments in insurance company subsidiaries were required to be deducted 50% from tier 1 capital and 50% from tier 2 capital. However, under Basel III the deduction is required to be made on a "corresponding deduction approach." Therefore, if a bank made an investment in an insurance company or other non-controlling investment by way of common shares, the full amount of the deduction would generally be required to be made from the available common share equity of the bank for Basel III purposes. In addition, the absolute amount of common share equity as a proportion of the capital structure has also been increased significantly. Under

[1] OSFI has indicated that through prudent capital retention, banks are expected to meet the new capital rules as early in the process as possible; the new rules in Basel III require that common equity, tier 1 capital and total capital must always exceed explicit minima of 4.5%, 6% and 8% of risk-weighted assets, respectively. Further, a capital conservation buffer of 2.5% is added to common share equity for a total of 7%, 8.5% and 10.5% respectively. Bank for International Settlements, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems*, December 2010 (rev. June 2011), online: Basel Committee–BIS <www.bis.org/publ/bcbs189.pdf>.

international rules prior to the financial crisis, it was possible for banks to hold common share equity representing as little as 2% of their risk-weighted capital requirements. This has been effectively increased to 7% when the new minimum of 4.5% is added to the capital conservation buffer of 2.5%. By contrast, going into the financial crisis, Canadian banks were required to have at least 5.5%–6% of their capital in the form of common share equity – significantly more than international requirements but significantly less than under the new proposals, particularly when the new deductions are factored into the calculation.

However, Canadian banks remain well positioned because of their higher capital requirements going into the financial crisis and their prudent capital retention during the financial crisis. As a result, most of the banks will be close to meeting the 2019 phased-in requirements early in the process.[2] To the extent possible, banks would prefer to fund the increase in the common share capital through retained earnings rather than new issues of common shares. However, this will not be possible with respect to any significant acquisitions.

The higher absolute and relative requirements to hold common share equity will reduce the amount of non-common share equity – that is, preferred shares and subordinated debt, which were the forms of capital that banks typically used to access the capital markets.

In addition, the new Basel III capital requirements state that all non-common capital instruments issued after January 1, 2013, must contain features that require these instruments to convert into common share equity if the bank becomes no longer viable (NVCC features). As a result, none of the existing outstanding capital of Canadian banks will qualify after the transition period unless the terms are amended or undertakings are filed to allow these instruments to qualify.[3] However, the phase-out period is quite generous and may provide significant capital-planning opportunities under the transition rules.

The transition rules fix the base of the nominal amount of all such instruments outstanding on January 1, 2013, and cap their recognition at 90% commencing on January 1, 2013, with the cap reducing by 10 percentage points each subsequent year. However, when a redemption occurs after 2013, the nominal base is not reduced for purposes of the calculation. Therefore, if a bank had, say, $1 billion worth of non-qualifying capital outstanding on January 1, 2013, and redeemed $200 million during 2013, then that $200 million would serve as "amortization shelter" and the bank would be able to treat all $800 million of its non-qualifying capital outstanding as eligible until 2015. This could create significant capital-planning opportunities, especially given the amount of capital that will be eligible for redemption at par between 2013 and 2015. It is also possible, given the amortization shelter that those redemptions will create, that it

[2] As of October 31, 2010, Canadian financial institutions had the following ratios:

RBC: Tier 1 capital is 13.0% and total capital is 14.4%.
Scotiabank: Tier 1 capital is 11.8% and total capital is 13.8%.
CIBC: Tier 1 capital is 13.9% and total capital is 17.8%.
TD: Tier 1 capital is 12.5% and total capital is 16.0%.
BMO: Tier 1 capital is 13.45% and total capital is 15.91%.
National Bank: Tier 1 capital is 14.0% and total capital is 17.5%.

Historically, none of the banks have set out a net common share equity ratio because a separate ratio was not required under Basel. However, using the October 2010 information, BMO calculated a pro-forma ratio of common equity at 7.8% and total tier 1 capital of 10.4%, based on the new definition of capital in Basel III and assuming full implementation of the announced capital deductions.

[3] CIBC announced on May 26, 2011, that it will seek NVCC treatment for certain of its preferred shares. Newswire, "CIBC announces intention to seek non-viability contingent capital treatment for its Class A preferred shares, Series 26, 27 and 29," online: (2011) <www.newswire.ca/en/releases/archive/May2011/26/c7134.html?view=print>.

will be desirable to issue additional preferred shares before January 1, 2013, without conversion features.

As noted above, to qualify as eligible capital after January 1, 2013, all non-common capital instruments will be required to have NVCC features. In February 2011, OSFI issued a draft advisory providing more clarity and specificity on these new requirements, with comments due by March 19, 2011. The advisory is expected to be finalized later in the year.[4] However, it is generally anticipated that the market will demand a significantly higher dividend or interest rate on the instruments with the NVCC features, particularly for the first few offerings. It is hoped that after the market becomes more comfortable with the remoteness of the trigger, the rates will decrease over time. As a result, in contrast to, say, the offering of innovative tier 1 capital when it was developed, there is no capital advantage to being the first institution to offer the new features. In fact, there likely is a disadvantage since it is widely expected that the first offerings will be required to include a significantly higher premium in the rate.

While the near term is bleak for capital raising for financial institutions, the longer term is much more positive.

As noted above, common share equity will become much more important for the capital requirements of the institution. By contrast, subordinated debt will become less important in the capital structure because it will no longer be eligible as capital for the leverage ratio, which is proposed after 2017 to be based solely on tier 1 capital,[5] and because a predominant amount of total capital needs to be in the form of common shares in any event.

In addition, innovative tier 1 capital will no longer be considered eligible capital even if it has NVCC triggers. The decreased importance of subordinated debt and the ineligible treatment of innovative tier 1 capital will raise significant capital-raising challenges for banks. Traditionally, in Canada subordinated debt and innovative tier 1 capital were purchased by institutional investors, particularly tax-exempt pension funds. Those investors have never shown much interest in purchasing preferred shares, which have been primarily sold to retail investors in Canada. However, without institutional investor interest, the preferred share market is fairly limited, with institutions generally being able to raise only $200 to $300 million in preferred shares at any given time. It is almost certain that the banks will be making considerable effort to develop an institutional base for preferred shares or possibly to gain greater access to the deeper liquid markets of the United States.

While the near term is bleak for capital raising for financial institutions, the longer term is much more positive. As noted above, none of the existing non-common capital qualifies as capital and it will be amortized on a straight basis between 2013 and 2023; although it will not all be replaced, given the predominance of common share equity under the new rules, a significant portion of it will need to be replaced with qualifying instruments.

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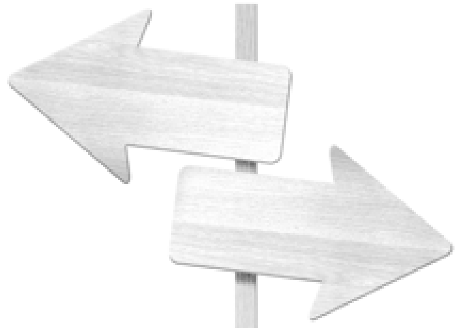
[4] Draft Advisory, February 2011, "Non-Viability Contingent Capital," online: <www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/capital/advisories/nvcc_dft_e.pdf>.

[5] Bank for International Settlements, *Basel III: A Global Regulatory Framework for More Resilient Banks and Banking Systems*, *supra* note 1 at 63.



Cross-Border Income Funds

This structure allows corporate entities interested in accessing market capital to offer a tax-efficient investment product that maximizes yield to investors

Scott R. Cochlan, Janan Paskaran, Renée Matthews

The use of a cross-border income fund enables a corporate entity to access market capital by offering investors an attractive, income-producing, tax-efficient investment product.

For many years, the mutual fund trust structure in Canada provided a viable and tax-efficient way for commercial entities to maximize yield to their investors by distributing their free cash flow to unitholders on a pre-tax basis, effectively eliminating taxation at the entity level. Following the Canadian government's introduction of the "SIFT trust" rules on October 31, 2006, certain trusts falling within the definition of a SIFT trust under the Canadian *Income Tax Act* would be taxed at corporate tax rates with respect to certain distributions made to unitholders. This change essentially extinguished the fiscal advantage that used to accrue to those using the income trust structure.

However, since the enactment of the new SIFT trust provision, further developments in the mutual fund trust structure have enabled certain Canadian companies to both raise significant market capital and provide a high return to investors on a tax-efficient basis. This has been made possible through the use of a cross-border income fund (CBIF). The basic structure of a CBIF involves a Canadian income fund that qualifies as (i) a "mutual fund trust" (Fund) by meeting the requirements of subsection 132(6) of the Act; (ii) a Canadian subtrust entity (Subtrust); and (iii) a U.S. limited partnership (LP) of which the subtrust is the limited partner, holding a 99.99% interest. The Fund indirectly acquires, through the Subtrust, either a business or an income-producing asset that is located in the United States and held by the U.S. partnership. Using the subscription capital raised from its public offering, the Fund invests in notes and units issued by the Subtrust, which in turn uses the proceeds to acquire its interest in the LP. The underlying U.S. business or asset is ultimately purchased by the LP with the funds received from the Subtrust, as well as borrowings often arranged under a senior credit facility.

From a Canadian taxation perspective, neither the Fund nor the Subtrust will be caught by the SIFT trust provision, as defined in subsection 122.1(1) of the Act (even though both entities reside in Canada and the Fund's units are publicly traded on a stock exchange), provided that the Fund does not hold any "non-portfolio property." Non-portfolio property is defined at subsection 122.1(1) to be

(i) a security *other than a portfolio investment entity*;

(ii) a *Canadian* real, immovable or resource property; or
(iii) a property that the trust uses in the course of carrying on a business *in Canada*.[1]

Essentially, the CBIF structure avoids SIFT treatment given that the ultimate business assets and operations are located outside Canada. The Fund's trust indenture should therefore strictly prohibit any investment in non-portfolio properties, and the Fund should ensure that its activities do not fall within (i), (ii) or (iii) above so that it is not caught offside of the SIFT trust taxation provision.

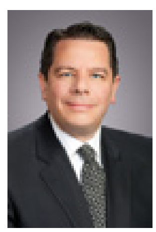
For U.S. taxation purposes, both the Fund and the Subtrust make a voluntary election to be treated as corporations, providing each with the benefit of not having the Internal Revenue Service "look through" the corporate structure when determining each entity's tax attributes. When such an election is made, none of the Subtrust's business and investment activities will be attributable to the Fund, and as the Fund is being treated as a Canadian corporation with no U.S. activities or interests, it should not have any U.S. tax liability. Moreover, individual unitholders will not be subject to U.S. tax liability or compliance obligations solely as a result of holding Fund units. The LP is transparent for tax purposes, and all the activities associated with the underlying business or asset will flow directly to, and be attributable to, the Subtrust. For U.S. tax purposes the Subtrust is therefore treated as carrying on the business of the LP directly and is able to claim applicable U.S. resource deductions, as well as interest deductions on the credit facility and on the notes held by the Fund.

In November 2010, Eagle Energy Trust completed its initial public offering, raising C$169.5 million utilizing the CBIF structure. The proceeds raised were then used to acquire a 73% working interest in the Salt Flat Field in south-central Texas. More recently, Alberta-based Parallel Energy Trust completed its initial public offering, raising C$342 million. It used the proceeds from its initial public offering and an advance under a credit facility to acquire a 51% interest in a natural gas property located in the West Panhandle Field in Texas.

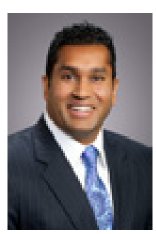
These two recent transactions may be indicative of an emerging trend among corporate entities interested in accessing market capital by offering a tax-efficient investment product that maximizes yield to investors.

Certain Canadian companies can now raise significant market capital *and* provide a high return to investors on a tax-efficient basis.

The use of a CBIF structure presents a viable option to entities focused on investing exclusively in foreign businesses or income-producing assets that management has identified as having an exploitable development opportunity that is capable of providing consistent, long-term cash flows.



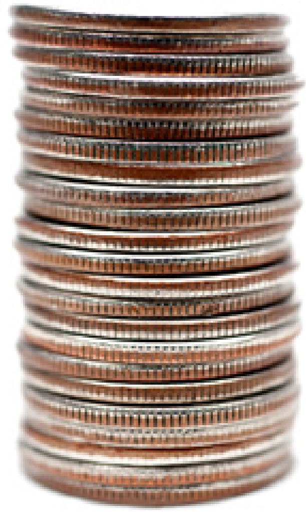
Scott R. Cochlan is recognized internationally as a leading Canadian corporate finance lawyer. He practises securities and corporate law, with an emphasis on corporate finance and M&A.



Janan Paskaran has advised on numerous cross-border debt and equity financings, and mergers and acquisitions. His practice focuses on corporate and securities law.

Renée Matthews' practice focuses on energy, environmental and corporate law, with emphasis on the commercial and regulatory aspects of power projects and oil and gas transactions.

[1] Our emphasis added.



High-Yield Debt Markets

Greater demand allows U.S. issuers more flexibility; Canadian issuers could follow

Amanda Balasubramanian, Jonathan Wiener

Much has been written recently about the emergence of a high-yield debt market in Canada. Canadian companies are taking notice and, in 2010, issued a record dollar amount of Canadian high-yield bonds. With over a dozen Canadian high-yield deals completed in 2010 and the high number of new issuances expected in 2011, a base of market terms for Canadian high-yield debt deals is developing.

The covenant pattern in Canadian high-yield indentures has been significantly influenced by, and has been very similar to, the covenant pattern in U.S. high-yield indentures. Typical covenants in a Canadian indenture have included restrictions on incurrence of additional debt, payments of dividends, distributions and other payments to junior stakeholders, investments, asset dispositions and transactions with affiliates. In addition, as in the United States, Canadian indentures have included a "no-call" provision, which prevents the issuer from redeeming the bonds in the first few years following issuance (typically a period equal to one-half of the notes' term) unless the issuer pays a "make-whole" and a declining prepayment premium thereafter.

High demand by investors for high-yield bonds in the United States in early 2010 allowed U.S. issuers to offer high-yield debt with less restrictive, more issuer-friendly terms. A number of such U.S. deals have permitted issuers to redeem up to 10% of the notes each year during the no-call period at a 103% redemption price. For example, an issuer of an eight-year note with a four-year no-call period could purchase up to 40% of the notes during the span of the no-call period at a significantly lower redemption price than the traditional make-whole. In recent examples, notes containing this feature were trading above 103% at the time of redemption, exposing holders to a loss on a portion of their note holdings. A number of deals also broadened the carve-outs from the restricted payments (payments of dividends, distributions and other payments to junior stakeholders) and indebtedness covenants beyond traditional bond limitations by permitting unlimited restricted payments and incurrence of unsecured debt if specified net leverage targets are met, in addition to retaining the traditional carve-outs.

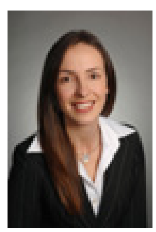
An increasing number of U.S. high-yield offerings in early 2010 – although still a small percentage of total U.S. deals – also included a pay-in-kind (PIK) toggle feature that allows the issuer to satisfy periodic interest payments through the issuance of additional notes rather than cash. Over US$2 billion worth of PIK notes were issued in the first four months of 2011, a sharp increase over the previous two years.

The covenant pattern in Canadian high-yield indentures has been significantly influenced by the covenant pattern in U.S. high-yield indentures.

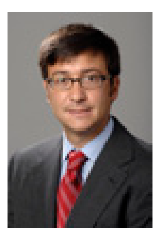
It remains to be seen whether these issuer-friendly terms will become permanent features in the U.S. market. There have been recent indications that U.S. investors are resisting these terms in favour of a more traditional covenant package.

A trend that we have seen in both U.S. and Canadian markets is the return of dividend recapitalizations, commonly referred to as "dividend recaps." In a dividend recap, bond proceeds are used to pay equity holders a dividend rather than to refinance debt, to fund an acquisition or to use for other general corporate purposes. Some dividend recaps have been used by private equity sponsors to increase leverage for portfolio companies that were purchased with a high percentage of equity during periods in 2008 and 2009 when debt financing was not as readily available. Dividend recaps are also a tool to return capital to equity investors when IPO markets are less active.

With investors' growing demand for high-yield debt in Canada and the U.S. market's influence of less restrictive and more issuer-friendly high-yield debt terms, it is possible that the Canadian market terms will move in that direction. However, the Canadian debt market has been historically more conservative than the U.S. market. In addition, the pool of investors is smaller in Canada than in the United States, which ultimately leaves it up to those Canadian investors to determine whether the Canadian market will follow the U.S. market in providing more flexibility for issuers in certain provisions or whether Canada will remain more conservative.



Amanda Balasubramanian's practice focuses on commercial banking and debt financings. She has extensive experience in a broad range of debt financings.



Jonathan Wiener's practice focuses on corporate law, with an emphasis on U.S. and cross-border private and public debt financing. He has extensive experience in lending and leverage finance transactions.

The OTC Derivatives Market

Significant upcoming changes will transform the market

Patricia Koval, Darren Baccus

A transformational change is occurring in what has been, to date, the largely unregulated global over-the-counter (OTC) derivatives market. Sweeping new regulatory proposals in Europe and new regulation in the United States under the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank) are being matched in Canada by a critical review of this area by securities regulators and legislative action by certain Canadian provinces.

In the OTC derivatives market, buy-side participants have traditionally transacted in swaps, forward contracts, options and a variety of other derivatives through contracts with counterparties under ISDA[1] agreements and related documentation. In Europe and in North America, under both Dodd-Frank and proposals issued by the Canadian Securities Administrators (CSA), this traditional market structure and practice will change significantly.

First, to the extent feasible and practical, OTC derivatives transactions will need to involve intermediaries: trades will have to be conducted through registrants qualified to conduct these trades, subject to limited exemptions. In some cases, such as in the United States under Dodd-Frank, substantial market participants may themselves also have to register in a newly created category as "major swap participants." Second, and perhaps more important, trades by most market participants, with the possible exception of non-financial corporate end-users, will generally be subject to mandatory clearing by an appropriate central clearing party. In this context, regulators will need to determine which OTC derivatives are suitable for central clearing, as well as the location and type of central clearing parties (including domestic solutions and/or the use of international clearing parties). Regulators will impose capital and collateral requirements on trades, subject to certain exemptions, and these requirements are expected to generally be higher for OTC derivatives transactions that cannot be centrally cleared for any reason. In particular, the CSA is generally proposing that capital or collateral requirements should apply to (i) financial intermediaries who facilitate OTC derivatives and trade on behalf of third parties, and (ii) end-users except where the use of OTC derivatives is restricted to hedging risks related to the end-user's business activities and does not increase systemic risk to the market. Exemptions may be established for defined categories of

[1] International Swaps and Derivatives Association, Inc.

end-users, but these will not likely include exemptions for speculative derivatives trades nor generally exempt financial entities, such as banks, dealers and hedge funds.

Another market transformational feature is that for OTC derivatives capable of being traded on an organized trading platform (i.e., one that is sufficiently standardized and liquid), trades will be required to be made over an exchange or other electronic derivatives execution facility. In addition, market participants will generally be subject to mandatory reporting of OTC derivatives trades to one or more trade repositories, on, where possible, a "real time" basis.

Ultimately, participants in the Canadian, U.S. and international OTC derivatives markets should be monitoring these regulatory developments in the markets in which they transact and should be planning for significant changes.

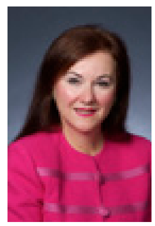
This massive regulatory reform of the global OTC derivatives market stems from the recent global financial crisis and the perceived exacerbating effect that OTC derivatives were believed to have had on the crisis. In 2009 and 2010, the G20 made commitments to significantly reform regulation to prevent activities in the OTC derivatives markets from posing future risk to the global financial system; to create greater efficiency and transparency of these markets; to prevent market manipulation, fraud and other abuses; and to ensure that OTC derivatives are not marketed to unsophisticated parties. The deadline imposed by the G20 for completion of this reform is 2012.

Prior to 2009, there was little regulatory oversight of the global OTC derivatives markets. In the United States, the applicable provisions of Dodd-Frank, Title VII, were passed in mid-2009, with implementation originally stated to be July 16, 2011. Under that legislation, the U.S. Commodity Futures Trading Commission and the Securities and Exchange Commission will share jurisdiction over derivatives, with the SEC having sole jurisdiction over security-based derivatives. Rule-making has been actively proceeding for some time, with implementation of key portions now delayed to December 31, 2011.

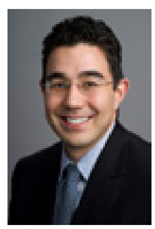
In Canada, Quebec established in 2009 a derivatives legislative framework, which imposes registration and disclosure requirements for trades in derivatives, but it largely exempts institutional OTC derivatives under the "accredited counterparties" exemption. The securities laws of the western provinces, notably British Columbia, Alberta and Manitoba, historically treated OTC derivatives as securities under securities legislation but also exempted most institutional OTC derivatives trades. In Ontario, where securities legislation contains rule-making power to regulate derivatives, a number of attempts have been made over the years to increase regulatory oversight of these markets. In December 2010, Bill 135 extended rule-making authority in respect of derivatives, including by permitting the Ontario Securities Commission to prescribe rules regarding clearing, settling and reporting of derivatives trades. In addition, certain provisions of Bill 135 that are not yet in force will give the OSC the power to prescribe classes of derivatives that must be traded on recognized exchanges or centrally cleared, prescribe registration requirements for derivatives dealers and derivatives advisers and identify "designated derivatives" for which prescribed disclosure documentation will be required.

The Ontario legislation and certain reforms now being reviewed by Alberta and other provinces follow from a national consultation initiated by the CSA regarding the Canadian OTC derivatives market. CSA Consultation Paper 91-401, published in November 2010, received broad general support from commentators. Currently, the CSA is working through the key recommendations (many of which are substantially similar to the legislation being developed in the United States under Dodd-Frank), with eight public consultation papers on various aspects expected to be published this year. CSA Consultation Paper 91-402 on trade repositories was published for comment on June 23, 2011.

Ultimately, participants in the Canadian, U.S. and international OTC derivatives markets should be monitoring these regulatory developments in the markets in which they transact and should be planning for significant changes. The proposals regarding new registration requirements for dealers and advisers in derivatives and for "major swap participants" in the United States are likely to increase costs and complexity for market participants unless exemptions are available. Hedge funds, mutual funds, pension funds, pooled funds and insurance companies could be subject to mandatory clearing and to its related costs and complexities. In addition, reporting requirements and other compliance requirements will probably require augmented internal controls and compliance structures for all those who trade in OTC derivatives. For those who trade in non-cleared OTC derivatives, there will likely be increased margin and capital requirements as well as potentially heightened governance and business conduct rules. Even a non-financial commercial end-user is likely to have enhanced record-keeping and reporting requirements, and to be required to make specific representations as to its status and the tagging of its trades (e.g., for hedging purposes) to dealers. Disclosure documentation for trades is also likely to be required, but it will probably be subject to certain types of exemptions such as those for "accredited investors" and for certain types of end-users.



Patricia Koval, recognized as a leading corporate and M&A lawyer in Canada, focuses on corporate and securities law, with emphasis on corporate finance (including investment funds).



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Shelf Prospectuses in Canada

An issuer's flexibility to tap the financial markets is dramatically improved by filing and maintaining a shelf prospectus

David Chaikof, Glen Johnson

Shelf prospectuses are a well-established part of the Canadian capital markets landscape. Since their introduction in 1991, they have given issuers significant flexibility in the structuring, timing and marketing of public offerings, compared with stand-alone offerings made under regular short form prospectuses or on a private placement basis. Canadian issuers are increasingly looking to take advantage of the shelf prospectus system's benefits as a tool for acquisition financing, enhanced marketing, investor targeting and streamlined access to domestic and U.S. markets.

A shelf prospectus is a variation of the short form prospectus and can be filed with the Canadian securities regulatory authorities. In contrast to a long form prospectus, it can incorporate required information by reference to other continuous disclosure documents (such as an annual information form, financial statements and management's discussion and analysis) that have previously been filed by the issuer. However, unlike both long form and regular short form prospectuses, the shelf prospectus does not qualify a specific offering of securities. Rather, it is effective for up to 25 months, during which time the issuer can make one or more securities offerings of the types contemplated in the prospectus, with a value up to the maximum limit specified on the prospectus cover. During that 25-month period, the shelf prospectus will automatically incorporate by reference the issuer's then-current continuous disclosure documents.

When an offering is planned, a relatively brief supplement to the shelf prospectus can be filed; the supplement details the specific terms of that offering and the securities being sold. As a result, the issuer's speed to market is dramatically improved, because limited new drafting is required and it can rely on its previously filed shelf prospectus and continuous disclosure documents.

The shelf prospectus rules allow for the qualification of any type of security – debt, common shares, preferred shares, warrants or other securities (a shelf prospectus that contemplates sales of many types of securities is referred to as an "unallocated shelf"). However, the rules may limit the types of securities that may be offered by a particular issuer using a shelf prospectus. Generally, an issuer that is eligible to file a short form prospectus will be able to file a shelf prospectus. An issuer whose equity securities are listed on the Toronto Stock Exchange, tiers 1 and 2 of the TSX Venture Exchange or the Canadian Trading and Quotation System (a fully qualified issuer) can distribute any type of securities under a shelf prospectus. Other issuers can file a shelf prospectus to distribute

(i) non-convertible debt or preferred shares that have an approved rating;
(ii) non-convertible debt securities, preferred shares or cash-settled derivatives that are guaranteed by a fully qualified issuer or by an issuer of similar securities having an approved rating;
(iii) convertible debt or preferred shares that are guaranteed by a fully qualified issuer; or
(iv) certain asset-backed securities.

A rights offering cannot be undertaken by way of a shelf prospectus.

For many Canadian issuers, one of the main advantages of the shelf prospectus system is being able to develop an integrated cross-border offering platform.

For many Canadian issuers, one of the main advantages of the shelf prospectus system is being able to develop an integrated cross-border offering platform. This can be achieved by filing a corresponding U.S. shelf prospectus under comparable U.S. securities rules or by relying on the Canada-U.S. Multijurisdictional Disclosure System (MJDS) and filing a U.S. shelf prospectus under an MJDS form. The U.S. Securities and Exchange Commission has proposed eliminating the U.S. registration statement categories that are premised on the credit ratings assigned to the securities being distributed. Instead, issuers that formerly relied on these categories to file a U.S. shelf prospectus could use other categories (such as those requiring a minimum public equity float) or a new category based on the issuance of at least US$1 billion of non-convertible securities (other than equity securities) in U.S. registered offerings in the preceding three years. Although most established Canadian issuers should continue to be able to access the U.S. markets with a cross-border shelf prospectus platform using either MJDS or other U.S. forms for the registration of securities, certain Canadian debt-only issuers may not be able to meet the new standard.

Another key feature of a shelf prospectus is that once it has been cleared by the securities regulatory authorities, the issuer is generally free to undertake offerings of the securities covered by the prospectus without further regulatory approvals. The supplements to the prospectus do not need to be reviewed or pre-cleared by the securities regulatory authorities before their use, subject to certain exceptions for "novel" securities such as warrants and structured products. This enhanced speed to market provides some additional timing and cost advantages over a regular short form prospectus offering.

The shelf prospectus also provides greater flexibility in assessing market interest in an issuer's securities. Since the securities in question are already covered by a final prospectus, the issuer does not face the same constraints on pre-marketing or communicating about an offering before a prospectus filing that would be associated with a regular long form or short form prospectus offering. This flexibility effectively allows issuers and their advisers to engage with target investors on proposed deal terms ahead of a public deal launch. For debt offerings under a shelf prospectus, issuers may prepare term sheets or draft supplements to the prospectus and distribute these to potential investors as a basis for further discussions and development of the offering's final terms and size. This deal development process can also prove helpful in challenging market conditions when an issuer may prefer not to go live with a planned offering if uncertain about being able to build a satisfactory order book. Issuers that assess market interest in this way still need to be mindful of their obligation to make timely disclosure of material information (such as a proposed offering that may affect the trading price of outstanding securities). In addition, the shelf prospectus rules require an issuer to issue a news release once it forms a "reasonable expectation" that it will issue equity securities under a shelf prospectus. These two factors may limit an issuer's ability to undertake soft marketing of equity securities in reliance on a shelf prospectus filing.

Another key feature of a shelf prospectus is that once it has been cleared by the securities regulatory authorities, the issuer is generally free to undertake offerings of the securities covered by the prospectus without further regulatory approvals.

Often, issuers will limit the types of securities that may be distributed under the shelf prospectus to those that they *are likely* to sell during the life of the shelf, rather than covering all types that they *may want* to sell in that period. That is due, in part, to a provision in the rules stating that the shelf prospectus must relate to the dollar value of securities that the issuer "reasonably expects" to distribute during the prospectus's 25-month life. However, issuers should keep in mind that it is not possible to amend a final shelf prospectus to add a new type of security. In other words, an issuer planning to finance an acquisition cannot offer subscription receipts under its shelf prospectus if it did not provide for that flexibility when the prospectus was filed. A final shelf prospectus can, however, be amended to increase the value of securities that may be sold. Accordingly, it may be beneficial to allow for issuances of more types of securities under the shelf prospectus at the time of filing or on renewing the prospectus. An issuer might also consider whether it wants the shelf prospectus to be available for resales of its securities by securityholders where an existing holder may have been granted "registration rights" to facilitate resales or where the issuer is otherwise required to allow a resale under Canadian or under U.S. securities laws through an MJDS shelf prospectus.

A shelf prospectus filing can entail costs associated with French translation. Quebec law technically requires the concurrent translation of all documents incorporated by reference in the prospectus during its 25-month life. In practice, many issuers appear to catch up on outstanding translations before a proposed offering, as is the case when a short form prospectus offering is planned. However, a number of issuers will instead exclude Quebec from a shelf prospectus filing, meaning that if an offering is made outside Quebec under the shelf prospectus, no public or private placement sales can be made at that time to Quebec residents.

Similarly, given the speed to market available in a shelf prospectus offering, issuers, underwriters and their advisers may focus their due diligence review at the time a shelf prospectus is originally filed, and undertake periodic due diligence updates (typically in conjunction with the filing of annual and quarterly continuous disclosure materials). All parties need to ensure that the due diligence process does not become perfunctory, as part of a scheduled process, in the absence of a live deal. Moreover, the regulatory expectation is that all appropriate due diligence investigations will have been undertaken by the time an offering is launched. The same standard of diligence and care associated with all public offerings must be applied, despite an issuer's ability to execute a deal promptly and efficiently under a shelf prospectus.

It's probably fair to say that the shelf prospectus system has been more readily embraced by issuers of debt securities. There continues to be a sense that the potential issuance of a significant dollar value of common shares or other equity under an unallocated shelf prospectus may contribute to "overhang" perceptions in the market – a concern that a dilutive issuance will occur, reducing the trading price of outstanding securities. There are also concerns that including too many different classes of securities as being eligible for issuance under a shelf prospectus could be confusing to investors and the marketplace at large. That being said, the advantages of the shelf prospectus system may outweigh those considerations for many issuers, particularly those who are anticipating significant fundraising and acquisition activity in the near term.

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U.S. Regulatory Initiatives

The United States continues to focus on corporate governance and shareholder democracy

Andrew J. Beck, Daniel Raglan

Institutional shareholders, hedge funds, activist investors and corporate raiders are today able to exercise significant influence over corporate governance matters as well as key business decisions of U.S. public companies – and we expect this pattern to continue during the next 12 months as regulatory agencies finalize and implement the various rules mandated under the 2010 *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank).

Most noticeably for U.S. public companies, Dodd-Frank requires non-binding shareholder votes on "say-on-pay," "say-when-on-pay" and "say-on-golden-parachutes." Less noticeably, but arguably more significantly, Dodd-Frank has also eliminated broker discretionary voting on executive compensation matters, which means that brokers cannot now vote on these matters without specific instructions from the beneficial owner. Before this change, broker discretionary votes accounted for between 15% and 20% of votes cast at many companies' shareholder meetings. Furthermore, e-voting has decreased small-shareholder participation. The aggregate impact of these developments has been to significantly enhance the relative voting power of institutional votes. When this power is coupled with the increased use of majority voting standards by U.S. public companies, pressure from proxy advisory firms and other activists will become even more acute.

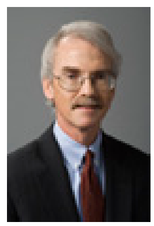
The continuation of a long trend toward greater shareholder involvement in corporate governance can be seen in the newly enacted and pending rules regarding proxy access, say-on-pay, enhanced Securities and Exchange Commission disclosure requirements, compensation clawbacks, board structure and elimination of broker discretionary voting in many areas. The trend was given significant momentum by the Enron scandal in 2001 and then the financial crisis of 2008. The great irony is, of course, that the shareholder base of most U.S. public companies rarely shares the long-term wealth-realization goals that this greater shareholder involvement is supposed to promote. The shareholder base of U.S. public companies listed on the New York Stock Exchange turns over nearly completely each year. Estimated hedge fund turnover is about 300% annually, and even the average portfolio turnover at actively managed mutual funds is about 100% annually.

A notable indicator of the narrowing of director discretion is that over 70% of the largest U.S. public companies have adopted majority voting in response to shareholder demands, following Delaware's passage of a majority voting statute in 2006. Institutional Shareholder Services will now recommend an across-the-board "withhold" or "against" vote on the board of directors of a U.S. public company if the directors do not act on a shareholder proposal that was approved by a majority of shares outstanding in the previous year or by a majority of votes cast in the previous year and one of the two preceding years.

The traditional deference given to boards of directors to run the corporation is, in many respects, a thing of the past.

The influence of proxy advisory firms is such that Vice Chancellor Leo Strine, Jr., of the Delaware Court of Chancery, based a finding that a shareholder rights plan did not preclude a proxy fight on the likelihood that a positive recommendation from RiskMetrics could enable a dissident to win an election despite the presence of over 30% insider ownership. As might have been expected, the SEC has announced it is reviewing the role and influence of proxy advisory firms. In response to such increasing investor pressure, it perhaps comes as no surprise that many U.S. public companies have acceded to investor demands by leveraging their balance sheets, taking more risks and pursuing very large stock buyback programs. The traditional deference given to boards of directors to run the corporation is, in many respects, a thing of the past.

To quote from an article by Vice Chancellor Strine in November 2010: "'More, More, More' was a horrible disco song and is an even worse approach to corporate governance reform. But, over time, that is the approach that has been taken." Unfortunately, we see no change coming over the next 12 months.



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Daniel Raglan represents corporate clients and financial institutions in U.S. domestic and cross-border capital markets transactions, and mergers and acquisitions.

Financing in the Canadian Mining Sector

Financing activity has been robust for Canadian mining sector issuers

Michael Amm, Michael Pickersgill

The first half of 2011 saw a continued high level of financing activity by Canadian mining sector issuers, with an aggregate value of offerings of C$8.4 billion, compared with C$15.2 billion during the entire year in 2010.[1] A total of 268 financings were completed during the first half of this year, on pace to match or exceed the volume of deal making in 2010. In addition to the high level of activity, a number of significant trends have emerged. First, the value of overall debt issuances has exceeded the value of equity issuances by a significant margin, a marked difference from the prior three years during which equity offerings predominated. Second, equity offerings have been trending to significantly lower deal sizes than during 2010. In the first half of 2011, there were only 15 equity offerings for more than C$50 million, whereas during 2010, there were 52 equity offerings in excess of C$50 million.

There are a number of reasons for these trends: overall financing activity has been supported by continued strong demand for resources from emerging markets, which in turn has led to sustained investor appetite in the capital markets for mining and other resource investment opportunities.

The smaller overall value of equity financings and reduced average deal sizes have resulted from two key factors. First, coming out of the financial crisis, many established production-stage mining companies took advantage of the rebound in the financial markets and commodity prices in 2009 and 2010 to complete their immediate equity recapitalization and financing needs. Second, the overall strength of the commodity sector continued to support financings by exploration and development issuers, which typically involve smaller offerings and lag behind financings by established producing issuers in the commodity cycle. As a result, a significant equity capital markets opportunity has been available to smaller-cap, early-stage issuers.

Factors that have contributed to the significant proportional increase in debt-financing activity include confidence in continued robust commodity prices by both issuers and investors; issuers' desire in that context to avoid dilution to existing shareholders through the issuance of new equity; and a thirst for yield from investors in a continued low interest rate environment.

Two key aspects of the recent debt-financing activity have been the significant amount raised by

[1] The statistics in this paragraph have been sourced from FPInfoMart.

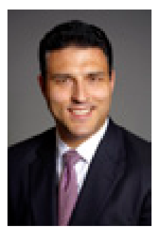
certain large-cap issuers and the issuance of high-yield and convertible debt by mid-cap and smaller issuers. In June 2011, both Barrick Gold and Teck Resources completed a series of large unsecured debt financings. Barrick Gold issued an aggregate of US$4 billion in notes, with the proceeds used primarily to finance its acquisition of Equinox Minerals. The notes were issued with maturity dates ranging from 2014 to 2041 and interest rates ranging from 1.75% to 5.70%. Teck Resources issued an aggregate of US$2 billion in notes, with the proceeds to be used for general corporate purposes, including capital spending for project development on its coal, copper and energy businesses and the repayment of debt. The notes were issued with maturity dates ranging from 2017 to 2041 and interest rates ranging from 3.15% to 6.25%.

Key trends include increased value of debt offerings and smaller equity offerings.

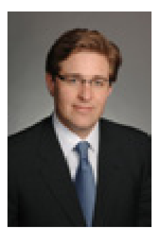
A number of notable financings have also involved the sale of high-yield and convertible debt. The use of high-yield debt continues a trend highlighted in 2009 when certain larger-cap miners (including Teck Resources) recapitalized in part through the debt capital markets. In the first half of 2011, mid-cap and smaller companies began to tap this market through high-yield and convertible debt offerings sold principally in the United States. These transactions included the following:

- Quadra FNX Mining raised US$500 million through the issue of 7.75% senior notes due 2019, with proceeds to be used to fund its Sierra Gorda copper-molybdenum project in Chile.
- Thompson Creek Metals raised US$350 million through the issue of 7.375% senior notes due 2018, with proceeds to be used primarily for the development of its Mt. Milligan gold and copper project.
- Taseko Mines raised US$200 million through the issue of 7.75% senior notes due 2019 to finance the expansion of its Gibraltar copper project.
- Jaguar Mining raised US$103.5 million through the issue of 5.5% senior convertible notes due 2016, with proceeds to be used primarily to finance development of its Gurupi gold project in northern Brazil.

The significant amount of capital raised in the first half of 2011 and the breadth of transaction structures and deal sizes demonstrate that the capital markets have continued to provide attractive financing opportunities for a wide range of Canadian mining sector issuers.



Michael Amm is a member of Torys' Mining and Metals Practice Group. His practice focuses on a broad range of corporate, commercial and securities law, with an emphasis on cross-border corporate finance and mergers and acquisitions.



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