TORYS

Capital Markets

Mid-Year Report
2016

Torys explores the nexus of industry, commerce and regulation.

Overview

Uncertainty lingered at the outset of 2016 in Canada from a slowdown in activity that began in the previous year: Q4 2015's total offerings raised an aggregate of approximately C$71 billion in gross proceeds, roughly C$6 billion below the average of the previous three quarters of 2015 combined. But as the first quarter of 2016 hit its stride, moderate gains in the dollar and promising activity—including much-welcomed upticks in the mining and oil and gas sectors—sparked optimism. However, these earlier gains have been stemmed by setbacks both macroeconomic and in the form of devastating wildfires suffered by the Fort McMurray community and surrounding areas. While the Bank of Canada has suggested that, among other factors, a return to production and repair efforts in Alberta and Saskatchewan may help spur growth in the last half of the year, Canada's economic outlook today looks a lot like it did at the start of 2016: low interest rates, low commodities prices, and a low dollar.

In addition to maintaining a steady watch on broader market conditions, boards on both sides of the Canada/U.S. border continue to face corporate governance challenges on a variety of fronts. In just a few years' time, shareholder-nominee "proxy access" by-laws have become commonplace in the U.S.—a trend stirring discussion about shareholder engagement on Canadian boards. The push for scrutiny on executive compensation practices shows no signs of abating; in this year's report, we take a closer look at what 2016 S&P/TSX60 proxy circulars can tell us about public companies' latest approaches to executive compensation. And with managing data breach risk by now a part of most board mandates, we are seeing governance organizations responding with best practices to combat and mitigate cyber attacks.

Other developments will be capturing market players' attention in the year ahead: in the United States, long-anticipated changes to inversion rules, if finalized, may have an impact on more than just inversions. In Canada, the first budget from the new federal government has brought a number of new tax rules targeting mutual funds and linked notes that will unsettle some foundational investment assumptions related to these financial products. Canadian investors have not stood still either, as some have increasingly looked to class action litigation to try to expand liability for underwriters acting in the Canadian secondary transactions market.

We hope you enjoy our analysis of these key issues driving the capital markets in 2016. Should you wish to discuss any of the topics in this report, please feel free to reach out to the authors.

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#1

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HYDRO ONE IPO

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Proxy Access and Shareholder Engagement

Aaron S. Emes, Mile T. Kurta

In the U.S., over 200 companies have recently adopted proxy access by-laws. What is proxy access? In short, it is the ability of a shareholder to include director nominees in the management proxy circular and to have those nominees listed directly on the company's proxy card, alongside management's proposed slate. Proxy access provides an alternative to a full-blown proxy contest for shareholders to nominate directors.

In Canada, the Canadian Coalition for Good Governance (CCGG) has publicly called for Canadian companies to implement proxy access. Alternatively, the Institute of Corporate Directors (ICD) has proposed guidance calling for greater engagement between shareholders and independent directors. The ICD approach would result in a substantial change from current practice, where shareholder engagement, at least prior to an activist intervention, is typically done by management.

Proxy Access in the U.S.

The typical U.S. proxy access by-law permits shareholders who hold at least three percent of the outstanding shares and who have held those shares for at least three years to nominate board members, to a maximum of between 20% and 25% of the board seats (this maximum is an aggregate for all shareholder nominees).

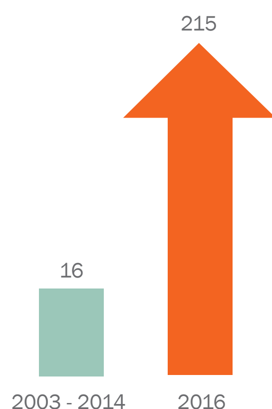
In the U.S., there is no legal obligation to provide proxy access and the adoption of proxy access by-laws has been a market-driven change, either by way of shareholder proposals supported by institutional investors or otherwise by U.S. companies voluntarily adopting proxy access by-laws.

Since the trend toward proxy access by-laws in the U.S. seems well-entrenched at this point, we would expect to continue to see more U.S. companies adopting proxy access by-laws in the coming years. Despite the growing trend in the U.S., to date we are not aware of any shareholder actually having nominated (or announced an intention to nominate) directors pursuant to such by-laws.

Typical U.S. Proxy Access Features	
Share ownership minimum Shareholders may form groups to meet this threshold.	3%
Minimum ownership period	3 years
Maximum % of shareholder appointees	20-25% of Board
Shareholders must represent that they are not seeking to change control of the company.	

While we are not aware of any Canadian companies having adopted proxy access to date, it is likely only a matter of time.

Figure 1. Spike in U.S. Proxy Access



Sources: Institutional Shareholders Services; CALPERS.

As Figure 1 shows, only 16 firms adopted proxy access from 2003-2014; in 2015, 117 firms adopted access. We expect that a comparable number of U.S. companies will adopt proxy access in 2016, either on their own initiative or in response to shareholder proposals.

Proxy Access in Canada

The CCGG's proxy access proposal is similar to the standard U.S. proxy access approach, with the following major exceptions. First, the CCGG proposal would have a 5% ownership threshold for companies with a market capitalization of less than $1 billion. Second, the CCGG proposal would not have any required period of share ownership prior to nomination.

We note that in Canada, unlike in the U.S., there are proxy access provisions in the corporate statutes. These provisions give shareholders holding at least 5% of the shares the ability to have nominees included in the management proxy circular. However, the current statutory provisions have rarely been used, and the CCGG believes they are inadequate. Statutory amendments would nonetheless be necessary to accommodate certain elements of the CCGG proposal.

To date, we are not aware of any Canadian company having adopted a proxy access by-law or policy. However, given the level of influence of U.S. governance developments in Canada and the desire of many cross-listed Canadian companies to follow U.S. practices—as well as the support of the CCGG—we expect that it is only a matter of time before a Canadian company does so. Whether proxy access in this form will see widespread adoption in Canada is a different story as there is resistance in some quarters to making any changes on the basis that current Canadian statutory provisions are more than sufficient. In other words, Canadian issuers should not rush to adopt a U.S. solution as a Canadian remedy may already be in place.

Director-Shareholder Engagement

The ICD's guidance on shareholder engagement indicates that boards of directors of Canada's public companies should directly engage with their significant shareholders on matters of corporate governance. Boards should know who their most

significant shareholders are and should obtain an understanding of the investing strategies and philosophies of those shareholders. Other helpful information for boards to know includes how those shareholders make voting decisions, the extent to which they rely on proxy advisory firms, and whether they have been adding to or reducing their shareholdings in the company.

With this information, the ICD contemplates regular meetings between shareholders and board members. The ICD suggests that the board be represented at these meetings by the chair (in Canada, the chair is typically an independent board member) and one other independent board member. Depending on the meeting agenda, it may also make sense to include committee chairs.

Areas that the ICD suggests for discussion at these meetings include board oversight of strategy, executive compensation, board composition and board oversight of risk. Other areas like corporate strategy and financial performance would continue to be matters of discussion between shareholders and management (and the ICD approach is not intended to replace engagement between shareholders and management). It is also important to ensure that directors participating in these meetings have the requisite skill set and background knowledge to engage meaningfully, and that they comply with securities law restrictions on selective disclosure of material non-public information.

In the U.S., large, long-term institutional investors have similarly called for direct engagement between directors and shareholders, proposing that a lead independent director or committee chair be responsible for shareholder engagement and even in some cases recommending a board committee responsible for shareholder engagement.

We expect that many Canadian issuers, regardless of their views on proxy access, will embrace the ICD's approach to shareholder engagement, as it will give them a better understanding of the views of shareholders on a regular basis and lessen the likelihood of serious issues arising in the future, including issues that might otherwise lead to an activist intervention. Regular engagement will work best in the case of long-term investors, where the benefits of an ongoing dialogue can be maximized.

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The C-Suite Has Skin in the Game: Governance Trends in Executive Compensation

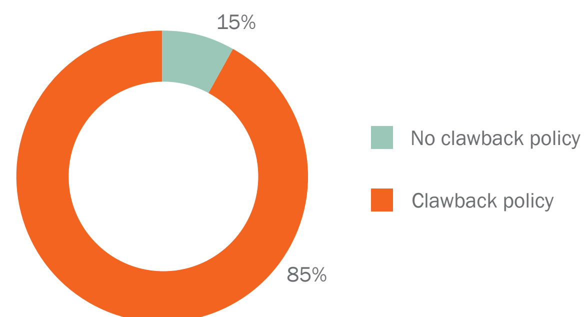
Lynne Lacoursière, Jennifer Lennon, Brad Tartick

Executive compensation continues to be a hot topic for investors, management teams and boards and is a subject of intensified public scrutiny. Accordingly, companies and their boards are spending more time ensuring their compensation policies and practices work to both align management and shareholder interests and link compensation to performance.

Clawbacks

Clawback or recoupment policies are one of the many ways in which companies guard against inappropriate executive pay. Clawbacks typically enable companies to recoup incentive compensation that is based on financial results that were subsequently restated or where the executive has engaged in misconduct. There are currently no Canadian rules mandating clawbacks of executive compensation, however, governance organizations, institutional investors and proxy advisory firms continue to advocate for the voluntary adoption of clawback policies. 85% of issuers in the S&P/TSX 60 index disclose a clawback policy (see Figure 1) and we expect this number to increase. The growing popularity of clawbacks comes at a time when issuers, still intent on deterring the risk-taking behaviour held partly responsible for the '08 crisis, are increasingly acknowledging the link between compensation and risk management.

Figure 1. Issuers With a Clawback Policy[1]

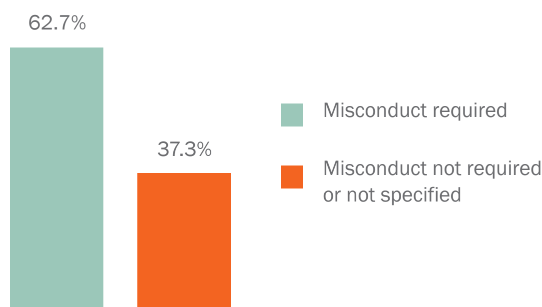


In 2015, the SEC proposed new executive compensation clawback rules under the Dodd-Frank Act that would apply to any issuer listed on a U.S. stock exchange, including Canadian MJDS issuers and other foreign private issuers. Issuers would need to adopt and enforce a clawback policy that complies with the rules or face potential delisting. Supplementing the existing U.S. clawback rules under the Sarbanes-Oxley Act, these proposed rules put at risk incentive compensation granted, vested

[1] All statistics in this article are based on the most recent proxy circular disclosure of issuers in the S&P/TSX 60 index.

The growing popularity of clawbacks comes at a time when issuers are increasingly acknowledging the link between compensation and risk management.

Figure 2. Clawback Policies Requiring Misconduct



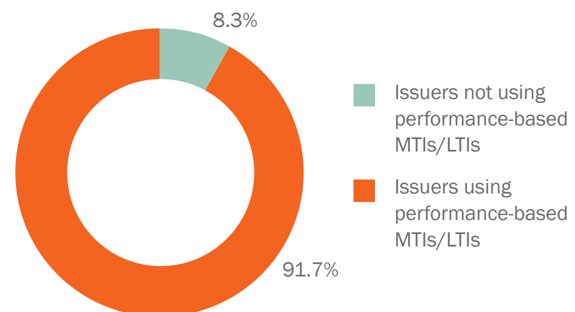
or earned based on a financial reporting measure (examples include revenue, EBITDA, operating cash flow, financial ratios, total shareholder return) where the issuer restates its financial statements to correct a material error. Unlike most clawback policies voluntarily adopted by issuers, the proposed SEC rules would require clawbacks to be triggered regardless of whether the restatement involved any misconduct, would apply to both current and former executives and would cover incentive compensation granted, vested or earned over a three-year look-back period. Although the proposed SEC rules are quite broad, clawbacks would not apply to awards that are granted and vested solely based on time (e.g., time-vested restricted share units and stock options).

With the final rules not yet published, U.S.-listed issuers will likely have until 2017 to adopt a compliant clawback policy. Issuers should nonetheless begin preparing for the new clawback requirements by considering the need for a revised or new policy and potential amendments to their incentive compensation arrangements. For example, issuers may want to consider providing a portion of long-term performance-based compensation that is not tied to financial reporting measures.

Pay for Performance

As demonstrated in Figure 3, medium-term and long-term awards that pay out based on the achievement of performance objectives are used by nearly all S&P/TSX 60 index issuers and account for a significant percentage of all longer-term incentive compensation for executives. Heightened shareholder scrutiny on problematic pay practices has led issuers to focus more attention on long-term performance rather than short-term gains in designing compensation arrangements.

Figure 3. Issuers Using Performance-Based Mid- and Long-Term Incentives



This trend is reflected in the increasing number of performance-based compensation arrangements used by issuers, as well as the number of objective

Figure 4. Prevalence of Equity-Based Compensation Combinations

Compensation Combinations	Prevalence
Performance Share Units (PSUs), Restricted Share Units (RSUs), Options & Other	30%
PSUs or RSUs, Options and Other	30%
PSUs, RSUs and Options	15%
PSUs or RSUs and Options	15%
PSUs, RSUs and Other	3.3%
Other Combination	6.7%
Note: "Other Combination" includes restricted stock and deferred share units.	

Figure 5. Performance Metrics Used by Issuers

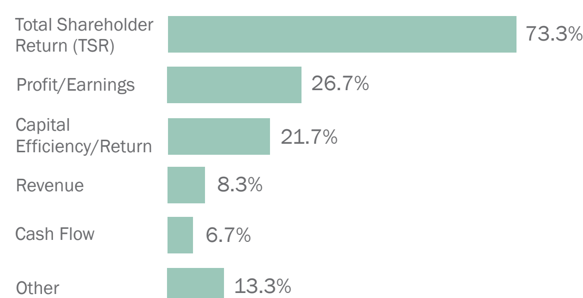
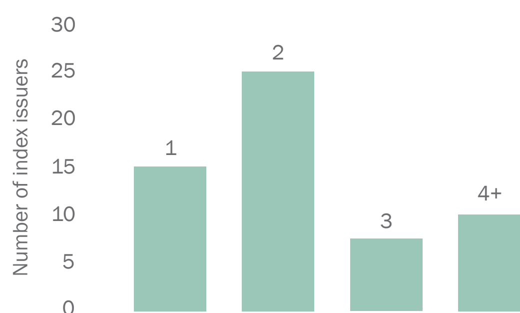


Figure 6. Number of Performance Metrics Used by Issuers



performance metrics that are used to evaluate company performance (see Figure 6). The most common performance metric S&P/TSX 60 index issuers are using is total shareholder return (TSR), which, when compared to an industry peer group (i.e., relative TSR), rewards industry outperformance based on stock prices. However, issuers are gradually including more performance metrics in their performance-based compensation arrangements that seek to evaluate and reward sustainable growth over the long term. Although TSR will likely remain one of the most prevalent performance metrics issuers use, we expect that over time its weighting against other metrics will decrease and its application is likely to evolve. For instance, some issuers are now using TSR as a positive or negative modifier or as a gating metric, whereby only if the target TSR is met will other performance metrics be evaluated and a payout potentially made.

In the U.S., proposed pay-for-performance rules under the Dodd-Frank Act will require issuers, other than Canadian MJDS issuers and other foreign private issuers, to provide clear, concise and understandable disclosure of any compensation awarded

Setting long-term performance targets that are challenging but attainable is often a constant struggle for companies.

to named executive officers, including describing how the executive's actual pay compares to the issuer's performance based on relative TSR. No similar rules have been proposed in Canada, however, a growing number of issuers voluntarily disclose information on CEO realized pay compared to company performance.

As a result of the significant focus on pay for performance, issuers must ensure appropriate performance metrics and targets are in place that reflect both their industry and organization. Setting long-term performance targets that are challenging but attainable is a constant struggle for companies, particularly when faced with volatile markets and other external forces. Boards must be mindful of how their compensation decisions will be explained to shareholders and should consider if and when it may be appropriate to exercise discretion to address unexpected changes impacting performance.

Share Ownership Guidelines and Hold Periods

Executives are commonly required to acquire and hold a certain amount of equity in the company (see Figure 7), usually expressed as a multiple of base salary, within a specified period of time following appointment (see Figure 9, p.13). Share ownership requirements are designed to align executive and shareholder interests, focus on long-term value creation and minimize excessive risk-taking. Ownership requirements can typically be met through direct or beneficial ownership of shares as well as

Figure 7. Issuers With Share Ownership Requirements

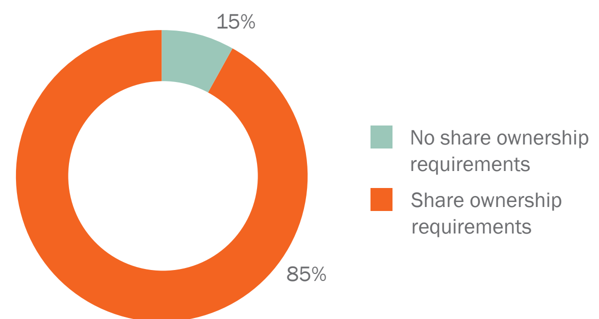
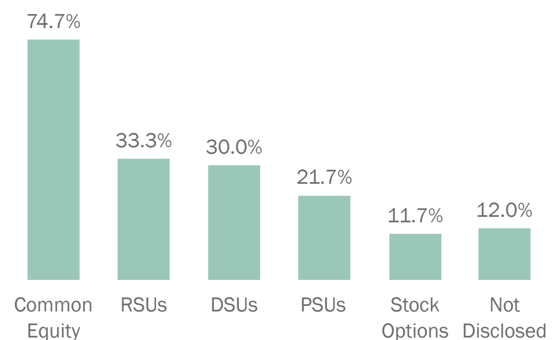


Figure 8. Acceptable Equity for Meeting Share Ownership Requirements



equity-based incentive awards. As demonstrated in Figure 8, restricted share units and deferred share units are often included in calculating an executive's ownership holdings, whereas performance share units and stock options are less commonly included. The time period in which executives are expected to satisfy the requirements ranges from three to five years from an executive's appointment, with five years being the most common.

Figure 9. CEO Share Ownership Requirements

Multiple of base salary	% of issuers
1x to 2x	2.0%
3x	16.0%
4x	20.0%
5x	40.0%
More than 5x	22.0%
Time period to meet share ownership requirement	**% of issuers**
1 to 4 years	13.3%
5 years	84.4%
5 or more years	2.2%

Share retention requirements or hold periods can impose share ownership requirements following retirement or resignation, or they can require that executives retain the after-tax value received on the exercise or settlement of equity-based compensation awards in shares for a specified period. These requirements are another way companies are ensuring the interests of their executive management teams are aligned with shareholders and that management is focused on long-term performance.

Conclusion

Whether to adopt clawbacks, performance-based compensation and share ownership guidelines are just a few of the many considerations involved in designing executive compensation arrangements. Now more than ever, issuers are providing enhanced compensation disclosure and refining their compensation arrangements to help ensure the C-suite stays focused on creating long-term value while avoiding undue risks.

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Oil and Gas: Midstream and Financing Activity on the Rise

Scott R. Cochlan, Ron Deyholos

Overall, activity in the Canadian oil and gas market has been significantly lower than normal over the past year, as equity markets in Canada remain subdued and investors continue to be cautious about investing in the sector. Despite this, activity has increased of late, especially in the midstream sector, as primarily upstream oil and gas companies divest non-core midstream assets to bolster their financial position or "unlock value"—and an increasing number of sector-related issuers, mainly midstream companies, are turning to the capital markets for financing to fund new deals.

Braving the Public Markets

The recent uptick in oil and gas companies accessing the capital markets has been cause for some optimism in the sector. Companies who have recently accessed the capital markets found that investors were highly receptive to their offerings, with many deals being oversubscribed and the underwriters' over-allotment options being fully exercised.

Midstream companies have taken to the capital markets this year to raise significant capital: in February, Enbridge Inc. raised C$2.3 billion from the issuance of common shares to fund its growth program over the next two years, and in April, both Pembina Pipeline Corporation (C$250 million) and TransCanada Corporation (C$500 million) announced offerings of preferred shares to fund capital expenditures, increase working capital and reduce debt. All of the offerings were fully subscribed, and Pembina's and TransCanada's offerings were so successful that both companies increased the sizes of their offerings.

In March, TransCanada Corporation announced that it would raise over C$4.2 billion in a bought deal financing of common shares as part of its major US$13 billion acquisition of Columbia Pipeline Group, Inc., a Houston-based company with a large interstate network of natural gas pipelines in the United States.

However, it has not been only midstream companies accessing the capital markets in recent months. Tourmaline Oil Corp., a Calgary-based intermediate oil and gas exploration company, closed a bought deal financing of common shares for over C$280 million in April, with the company announcing that the funds would temporarily be used to repay its credit facility and used later to finance working capital and potential future acquisitions. Likewise, Secure Energy Services (C$150 million), Raging River Exploration Inc. (C$108 million), Advantage Oil and Gas Ltd. (C$100 million), Spartan Energy Corp. (C$96 million), Whitecap Resources Inc. (C$95 million), Kelt Exploration Ltd. (C$75 million), Canyon Services Group Inc. (C$63 million),

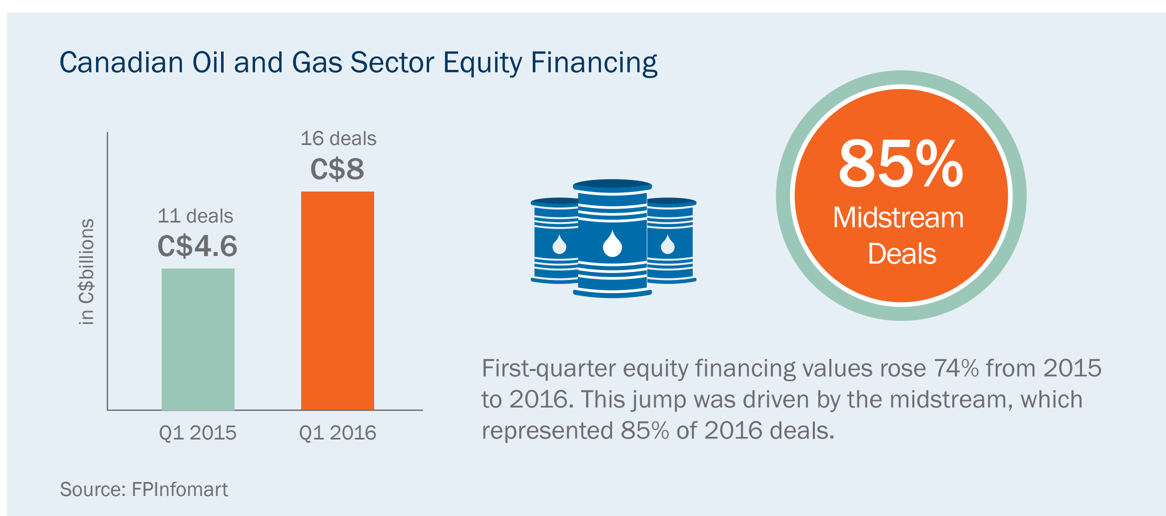
Companies who have recently accessed the capital markets found that investors were highly receptive to their offerings, with many deals being oversubscribed.

Newalta Corporation (C$54 million), Tamarack Valley Energy Ltd. (C$44 million), RMP Energy Inc. (C$34.5 million), and Petrowest Corporation (C$10 million) have all accessed the capital markets this year, primarily to reduce indebtedness, fund capital expenditures and use for general corporate purposes. These offerings, while comparatively small, suggest growing investor interest in the oil and gas sector beyond midstream companies.

"Unlocking the Value" of Midstream Assets

Even as the oil and gas market has remained generally soft, the growing number of divestitures of midstream assets by integrated or primarily upstream oil and gas companies has dominated the market. Oil and gas companies searching for sources of capital to ride out low oil prices are monetizing their oftentimes significant midstream assets to focus on their core, upstream assets.

We saw the emergence of this trend in the past couple of years. Encana Corporation concluded an agreement to sell natural gas pipeline and processing assets in the Montney area of British Columbia, owned by Encana and its partnership with a subsidiary of Mitsubishi Corporation, to Veresen Inc. and KKR & Co. LP for C$760 million in April 2015, in an effort to raise capital to fund the development of its large portfolio of upstream assets. Veresen and KKR's resulting partnership, Veresen Midstream LP, additionally committed to invest C$5 billion in new infrastructure for the Montney area in the coming 30 years.



Starting in 2016, the appetite for midstream divestitures appears to have increased dramatically. In January, Enbridge Inc. announced a C$538 million deal to acquire gas plants and related pipelines in northeastern British Columbia from Murphy Oil Corporation, a U.S.-based upstream producer. In addition, after putting its midstream assets up for sale in January, Paramount Resources Ltd., a Calgary-based intermediate oil and gas company, announced in March that it had made a deal with Pembina Pipeline Corporation for C$556 million, which Paramount used to pay down debt. Notably, Pembina raised funds for the acquisition partially through a C$345 million bought deal financing of common shares, which is in addition to its previously mentioned offering of preferred shares.

Likewise, Husky Energy Inc. announced a deal on April 25 for the sale of 65% of its interest in certain midstream assets in Alberta and Saskatchewan to Cheung Kong Infrastructure and Power Assets Holdings Limited for C$1.7 billion. Husky intends to strengthen its balance sheet by using the proceeds to pay down debt. The assets will be held by a new limited partnership that will maintain integration with Husky's upstream and refining assets, with Husky continuing to hold a 35% interest and act as operator.

Conclusion

The depressed oil and gas markets have not affected all companies equally: midstream companies looking to the capital markets to fund major deals in particular are finding investors highly receptive to new equity offerings. And some oil and gas exploration and production companies are finding they are not entirely locked out of the markets and have successfully raised funds this year in a series of offerings. We anticipate that distressed integrated and upstream oil and gas companies will continue to look at divesting non-core and midstream assets to improve their balance sheets, especially in the face of today's low oil price environment and depressed equity prices.

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All Hands on Deck: Mitigating Cyber Attacks

Adam S. Armstrong, Joel Ramsey, Steven Slavens, Marko Trivun

As big and costly cyber attacks have recently illustrated, long gone are the days when directors and general counsel could feign technophobia and relegate mitigating cyber risk to an organization's IT department. With the risk of class action litigation, loss of public and customer confidence and high remediation costs, a company must take an "all hands on deck" approach if they want to decrease the likelihood, and consequences, of a cyber attack.

General Counsel's Role

Disclosure

An April 2016 report by the Board of the International Organization of Securities Commissions (IOSCO) emphasized that existing disclosure requirements for issuers apply in the context of material cyber risk information. Based on a review of issuer disclosure practices, the report identifies factors to consider for issuers for whom cyber risk constitutes a material risk:

- why is the issuer subject to cyber risk;
- what is the source and nature of the cyber risk;
- what are the possible outcomes of a cyber incident (for example, explain the effects on reputation, customer confidence, stakeholders and other third-parties, set out the cost of remediation after a breach);
- how adequate are the issuer's preventative measures and management's strategy for mitigating cyber risk; and
- did a material breach previously occur and did it affect the issuer's overall cyber risk.[1]

In addition, the Canadian Coalition for Good Governance's (CCGG) *2015 Best Practices for Proxy Circular Disclosure Guidance* tells boards to generally disclose the process they use to identify and monitor risk management efforts. The guidance applauded specific inclusion in disclosure documents of cyber risks, including the treatment of cybersecurity, sensitive data loss, service disruption and customer retention.

Of course, reporting issuers will need to balance appropriate disclosure of cyber risk management without compromising its (cybersecurity), as certain disclosures may have the effect of making issuers the target of malicious attacks, or worse, disclosing the actual vulnerabilities of the issuer to bad actors.

[1] Available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD528.pdf.

Securities regulators now see cyber risk as a core part of any company's corporate risk management practices and processes.

The future of securities regulation in the area of cyber risk is unclear. In the U.S., the proposed *Cybersecurity Disclosure Act of 2015* seeks to improve how public companies disclose cybersecurity risks—and as a result, hopes to improve corporate cybersecurity practices and protect the public by way of a comply-or-explain regime. If the bill in its current form becomes law, reporting issuers in the U.S. would be required to:

1. "disclose in its mandatory annual report or annual proxy statement whether any member of its governing body has expertise or experience in cybersecurity, including details necessary to describe fully the nature of that expertise or experience; and

2. if no member has such expertise or experience, describe what other company cybersecurity steps were taken into account by any persons, such as a nominating committee, responsible for identifying and evaluating nominees for the governing body."[2]

In Canada, Canadian Securities Administrators' Staff Notice 11-326, *Cyber Security*, urges issuers that have already taken steps to address cybersecurity to "review their cyber security risk control measures on a regular basis" but there is currently no disclosure obligation analogous to the U.S. *Cybersecurity Disclosure Act of 2015*.[3]

While it remains to be seen if more robust regulatory schemes will emerge, collectively, these trends indicate that securities regulators see cyber risk as a core part of any company's corporate risk management practices and processes. Canadian federally regulated financial institutions (FRFIs) under the Office of the Superintendent of Financial Institutions (OSFI) and dealers regulated under the Investment Industry Regulatory Organization of Canada (IIROC) already face heightened regulatory scrutiny related to cybersecurity. In 2013, OSFI released its *Cyber Security Self-Assessment Guidance* to help FRFIs "assess their current level of preparedness, and to develop and maintain effective cyber security practices." The guide asks FRFIs to rank themselves on a range of criteria organized around six broad topics: organization and resources; cyber risk and control assessment; situational awareness; threat and vulnerability risk management; cybersecurity incident management; and cybersecurity governance. IIROC also published two guidelines to help dealers improve their resilience to cyber attacks.[4] Because FRFIs are often early adopters of governance best practices, the guidance their regulatory bodies provide may offer insight to other companies when assessing their own cybersecurity governance approach.

[2] Available at: https://www.congress.gov/bill/114th-congress/senate-bill/2410.

[3] Available at: http://www.osc.gov.on.ca/en/SecuritiesLaw_csa_20130926_11-326_cyber-security.htm.

[4] Available at: http://www.iiroc.ca/industry/cybersecurity/Pages/default.aspx.

The Price of a Data Breach

US$3.8M

Average cost

US$154

per record breached

Source: Ponemon Institute. Available at: http://www-03.ibm.com/security/infographics/data-breach/.

Commercial Contracts and Vendor Management

Your organization may not be the weakest link in managing your cybersecurity risk. It has become critical to have a comprehensive vendor management process to screen vendors and determine the access they should have to your systems and data. A risk-based approach to outsourcing and storage of data will help issuers protect their data while still taking advantage of the latest services being offered by vendors. Legal departments should work closely with stakeholders and experts within the company to understand both the risks and the rewards of purchasing a suite of services from a vendor and take appropriate steps to mitigate the risks without losing all the rewards.

Prior to entering into a contract with a vendor, companies need to perform thorough due diligence on a vendor's reputation, financial viability—and where applicable and possible, get comfortable that the vendor has sufficient cybersecurity controls in place.

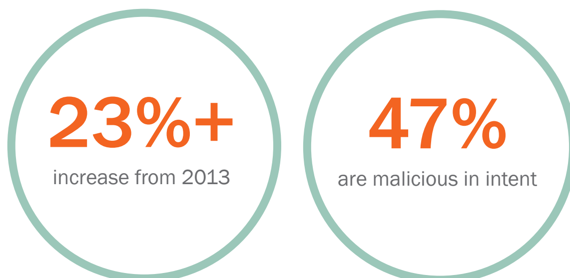
Following the intake process, general counsel needs to make sure that its commercial contracts contain provisions that can appropriately mitigate risks associated with the services. These include:

- sufficient indemnity obligations for privacy, data and information security breaches;
- uncapped limitation of liability for vendor's breaches relating to cybersecurity obligations (or if it is not possible to negotiate an uncapped limit, an alternative, specific and potentially higher cap;
- audit rights;
- incident management;
- strong definition of and obligations relating to confidential information and customer data;
- business continuity planning;
- reporting obligations;

- warranties on compliance with applicable laws (including privacy laws) and with your company's information security requirements;
- handling of data and media storage; and
- service levels and related remedies.

A strong set of standard contract requirements and an appropriate process for making exceptions on a case-by-case basis can form the backbone of an approach to contracting that allows companies to thrive in the marketplace while still remaining accountable to shareholders and regulators.

Data Breaches on the Rise



Data breaches have risen by almost 25% in a few years' time. Almost half of these are malicious—and as such, cost more to remediate.

For companies with internal expertise gaps in this area, outside counsel may be needed to ensure the successful execution of commercial contracts in which technology and cybersecurity considerations are key.

Board's Role

With an overall responsibility to oversee the affairs of the company, including a legal duty to manage risk, directors can exercise this duty in one of three ways:

1. reserve one or more board seats for a member with technology expertise;
2. consult independent cybersecurity experts; or
3. delegate the role to management, while continuing to exercise appropriate oversight.

The last option is now viable for a shrinking number of companies, and the second approach may be appropriate only for companies where technology plays a role but is not essential to the business. If technology is key to how a company derives profit, a company need directors with technology expertise and experience.

Furthermore, just as public companies must audit their financial statements, companies should audit their security controls and practices on a regular basis and the results should be reported to the board (or a committee of the board) and senior management. Depending on the circumstances, it may be prudent to engage third-party security experts to perform the audit.

If technology is key to how a company derives profit, it company need directors with technology expertise and experience.

Management's Role

IOSCO's April 2016 report referenced earlier also discusses practices adopted by market participants affected by cyber risk, specifying five broad strategy components, outlined in detail below, that issuers should consider: *identification*, *protection*, *detection*, *response* and *recovery*.

Initially, critical assets, information and surveillance systems must be *identified*, and the report suggests that this should involve creating and keeping up-to-date an inventory of all hardware and software, including any third-party security assessments.

Protection measures that can be considered to enhance cybersecurity can be organizational or technical. It is at this stage that risk assessments as well as employee training initiatives (including ongoing initiatives such as tests to assess staff proficiency) are useful tools. Organizations are also encouraged to take on initiatives such as monthly security bulletins and other routine communications with staff to emphasize areas of vulnerability, generally promote awareness and empower staff to speak out in the event of a possible attack.

Both external and internal monitoring is suggested to assist in *detection*. This includes monitoring traffic and logs regarding access, and keeping account of access to file servers and database activity.

Response planning involves the preparation of a communication strategy to inform relevant stakeholders, tools to understand the breach or attack, a database tracking attacks and administering cyber drills.

Recovery is firm-specific, but will require a communication component with internal and external stakeholders and should factor in recovery time and point objectives.

Conclusion

As the regulatory landscape and best practices regarding cyber risk continue to develop, an issuer's leadership need to begin treating cyber risks similarly to other material risks facing the company. Appropriate disclosure, employing a risk based approach, and creating a strong role for management will help issuers be responsive to mark trends and regulatory requirements.

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Underwriters Under Scrutiny: Liability to Secondary Market Purchasers

Gillian B. Dingle, John A. Fabello

During the first half of 2016, class action plaintiffs took steps to expand the liability of underwriters under the Ontario *Securities Act* (the Act).[1] While the Act does allow investors who purchase securities in a public offering to sue the offering's underwriters, when it comes to secondary market transactions, the Act does not include "underwriters" in the list of parties who may be sued for secondary market liability. Recent cases have seen class action plaintiffs attempt to characterize an underwriter as both a "promoter" and an "expert," both categories of persons that may be sued for liability to secondary market investors under Part XXIII.1.

Underwriters Under the *Securities Act*

Part XXIII.1 of the Act deals with liability for misrepresentations in an issuer's continuous disclosure documents. It allows an investor who purchased shares other than through a public offering—for example, by buying over a stock exchange—to claim for damages against a number of capital markets participants. Historically, the efforts of investors who purchased in the secondary market to bring class proceedings for common law negligent misrepresentation have been thwarted because of the requirement that each individual investor prove reliance. The introduction of Part XXIII.1 in December 2005 represented a sea change for investors, creating a cause of action for secondary market misrepresentation without the requirement that each investor prove reliance on the alleged misrepresentation.

The Act lists the types of market participants who may be liable to secondary market investors. This list is limited to (a) the issuer, (b) certain directors and officers (c) "influential persons," including "promoters" and directors and officers of those influential persons and (d) "experts" in certain circumstances.[2] Underwriters are not included

[1] R.S.O. 1990 c. S.5 (the Act).

[2] Note that the parties who may be liable for a misrepresentation differ slightly where the misrepresentation is in a document as opposed to where it is contained in a public oral statement. As it is unlikely that underwriters will make public oral statements about offerings in which they are involved, our comments are restricted to misrepresentations in documents.

Recent cases have seen class action plaintiffs attempt to characterize an underwriter as both a "promoter" and an "expert," both categories of persons that may be sued for liability to secondary market investors.

in the list, but class action plaintiffs have argued that investment dealers who act as underwriters in an offering should also be considered promoters (a type of "influential person") and experts under Part XXIII.1, exposing them to liability for secondary market misrepresentation claims under the Act.

Underwriter as "Promoter?"

Under the Act, a promoter is a person or company who, acting alone or in conjunction with others, directly or indirectly takes the initiative in founding, organizing or substantially reorganizing the business of an issuer.[3] The question of whether an underwriter could be considered a "promoter" was addressed in *Goldsmith v. National Bank of Canada*.[4] In that case, National Bank of Canada and its subsidiary National Bank Financial (NBF) had offered banking, financial advisory and underwriting services to Open Range Energy Corp. and to Poseidon Concepts Corp., an entity spun out of Open Range Energy through a reorganization that occurred by way of a plan of arrangement. Poseidon had engaged in an equity offering for which NBF acted as lead underwriter and the plaintiff alleged that the prospectus for the offering contained misrepresentations about Poseidon's financial condition.

Poseidon filed for CCAA protection in the spring of 2013, leaving aggrieved investors with limited targets for compensation on their losses. The Goldsmith case was commenced against National Bank on the basis that it, acting in conjunction with others including National Bank Financial, was a promoter. The plaintiff alleged that the services offered by National Bank and NBF were "essential" to the reorganization that had resulted in the creation of Poseidon. However, in considering all of the varied arguments the plaintiff offered as to why National Bank, together with NBF, should be considered a promoter, the motions judge concluded that when a bank, financial adviser or underwriter did nothing more than offer the services it had agreed to offer, it could not—without more—be considered a promoter.[5]

The plaintiff appealed this decision to the Court of Appeal on the basis that, among other arguments, the definition of promoter was elastic and the definition applied by the motions judge was too narrow.[6] In its decision in early 2016, the Court of Appeal rejected the plaintiff's argument. It found that the phrase "taking the initiative" as used in the definition of promoter required some autonomous conduct beyond simply applying influence (as the plaintiff claimed National Bank had done), and the legislative framework suggested that a promoter

[3] *Act*, s. 1(1).

[4] 2015 ONSC 2746 (*Goldsmith*).

[5] *Goldsmith* at paras. 26-29.

[6] *2016 ONCA 22.*

must play a closer role in an issuer's business than simply exercising influence over decision makers.[7] This decision will not eliminate the possibility that an underwriter could be found to be a promoter, but it will be difficult for a court to accept that an underwriter simply acting as underwriter, without more, should be liable to secondary market purchasers as a promoter.

Underwriter as "Expert?"

The issue of whether an underwriter can be considered an "expert" was raised in a proposed class action against Allied Nevada Gold Corp. (Allied Nevada), a mining issuer that had filed for bankruptcy protection in the United States, and the underwriters that had assisted with its secondary public offering. The claim alleged that Allied Nevada had failed to disclose certain operational and financing difficulties it was experiencing at its mine. After Allied Nevada filed for bankruptcy, the plaintiff sought leave to amend its claim to add the underwriters, and to claim against the underwriters on behalf of secondary market purchasers.[8]

The plaintiff's claim was that in certifying that the prospectus for the secondary public offering contained "full, true and plain" disclosure (as is required under the Act), the underwriters were acting as experts. To the extent that the prospectus contained material misrepresentations, the plaintiff claimed these misrepresentations were statements of the underwriters by virtue of their certification. In response, the underwriters argued that this broad interpretation of the definition of "expert" would effectively "expertize" the entire content of the prospectus. Under National Instrument 41-101, issuers are required to file the consent of any expert who has prepared or certified (and, therefore, "expertized") a portion of the prospectus, or a report, statement or opinion referred to in the prospectus.[9] This is an important protection for issuers because under the Act, an issuer will not be liable for any misrepresentation purporting to be made on the authority of an expert or purporting to be a copy of or extract from a report, statement or opinion of an expert. The underwriters argued that the plaintiff's position was contrary to the intentions of the legislature, and that since Part XXIII.1 the Act did not make reference to underwriters, an investment dealer who acted only as an underwriter was excluded from that statutory cause of action.

[7] *Ibid*. at paras. 39, 43, 46.

[8] Note that Torys LLP acts for the underwriters in this case. A similar argument was raised in *Wright v. Detour Gold Corporation et al*. (Court File No. CV-14-504010). In that case, the plaintiff also sought to add the underwriters as parties to the proceeding on a number of bases, including that the underwriters were "experts" under section 138.3(1)(e). The motion to amend the claim was resolved on the basis that the underwriters be added as defendants to the proposed secondary market misrepresentation claim only. As the underwriters were added by agreement between the parties, the issue of whether underwriters could properly be considered experts was not decided by the Court.

[9] NI41-101, s. 10.1.

The Court rejected the plaintiff's claim that underwriters should be considered "experts" on two grounds.[10] First, the Court noted that in order for liability to attach to an expert, the disclosure must repeat a misrepresentation contained in the expert's report, statement or opinion. In this case, the underwriters' certification did not repeat any misrepresentations previously made.[11] Second and more importantly, the Court reviewed the language of the relevant provisions in the Act and concluded that the legislature did not intend for underwriters to be caught by the secondary market liability provisions of Part XXIII.1.[12]

Conclusion

Though each case is decided on its own unique facts, the *Goldsmith and Allied Nevada* decisions suggest that the Court will not expand the liability of underwriters under the Act in situations where the role of the investment dealer in issue is limited to the task of underwriting, as distinct from an investment dealer who also, or separately, acts as a promoter or expert, as those terms are defined by the legislation.

[10] *LBP Holdings v. Allied Nevada Gold Corp.*, 2016 ONSC 1629.

[11] *Ibid.* at para. 44.

[12] *Ibid.* at para. 47.

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U.S. and Canada Tax Developments

David Mattingly, Scott Semer, John J. Tobin, Jerald M. Wortsman

Change has been in the air this spring for tax regimes on both sides of the Canada-U.S. border. And in both countries, some of the changes carry with them potential unintended consequences that transcend the scope of what the rules were intended to target. Discussed in detail below, in the U.S., newly released regulations attacking U.S. tax inversions also affect some debt instruments; and in Canada, the new federal government's budget includes proposed rules that have significant implications for linked notes and tax switches in mutual fund corporations.

U.S. Update

Proposed Regulations Target Inversions—But Hit Intercompany Debt

On April 4, 2016, the U.S. Department of the Treasury released comprehensive regulations attacking U.S. tax inversions (for a definition of inversions, see page 38), taking a two-pronged approach. One set of regulations strengthens the existing tax inversion rules by causing more transactions to be treated as meeting the 80% threshold (for example by ignoring certain shareholders). These strengthened regulations generally had immediate effect. For example, they were widely reported to have halted the proposed combination of Pfizer and Allergan.

A second set of regulations focuses on earnings stripping. In a successful inversion earnings stripping involves the payment of deductible interest by a U.S. corporation to its new foreign parent. Many taxpayers had expected earnings stripping to be attacked by applying existing interest disallowance rules more strongly in the inversion context. Surprisingly, Treasury adopted an unusual approach based on a long-dormant provision of the U.S. Internal Revenue Code—section 385, which addresses whether an instrument issued by a corporation should be treated as debt or equity. The new debt-equity regulations under section 385 are issued only in proposed form, but if finalized, could apply retroactively to certain debt instruments issued on or after April 4, 2016, and would apply in a broad array of contexts that have little to do with inversions.

This set of proposed rules under section 385 would generally apply to any cross-border loan involving a U.S. subsidiary or partnership, as long as the non-U.S. parent owns at least 80% (or 50% in some cases) of the vote or value of the U.S. borrower. The draft rules have three main components, which we expand on: (i) treatment as part debt and part equity; (ii) documentation required to sustain debt treatment; and (iii) debt distributions treated as equity.

The Treasury's unusual approach to thwarting inversions would apply in an array of contexts that have little to do with inversions.

Treatment as Part Debt and Part Equity

Under current law, an instrument is generally treated either entirely as debt or entirely as equity. The new rules will allow the IRS to characterize a single instrument issued by related parties with 50% overlapping ownership as part debt and part equity. For example, if there is a $50 million loan, but only $30 million is likely to be repaid, then $20 million can be reclassified as equity.

Documentation Required to Sustain Debt Treatment

Debt between 80% related parties will be required to satisfy four record-keeping requirements. A failure to satisfy any of these requirements will cause the debt to be treated as equity and include documentation:

1. as debt;
2. of typical creditor's rights;
3. of a reasonable expectation of repayment; and
4. of a genuine debtor-creditor relationship.

A reasonable expectation of repayment would be documented with cash flow projections, financial statements, debt-equity and other financial ratios, and the like. A genuine debtor-creditor relationship would be documented by showing compliance with the terms of the debt, such as regular repayment. In the event of a default, the documentation must demonstrate the creditor's reasonable diligence and judgment, including attempts to enforce or cure a default, as well as any deliberations surrounding a decision not to exercise default rights.

Debt Distributions Treated as Equity

Under the new rules, distribution of a debt instrument to a related shareholder will generally be treated as equity rather than debt. This rule targets the issuance of new debt for no new capital, but potentially sweeps in many other transactions. To

U.S. Inversions

In a typical inversion, a U.S. corporation and a foreign partner effectively become subsidiaries of an existing or new foreign holding company located in a low-tax jurisdiction such as Ireland. Shareholders of the U.S. corporation transfer their shares to the new foreign parent in exchange for parent stock and possibly other consideration.

The key to a successful inversion is that former shareholders of the U.S. corporation must own less than 80% of the stock of the new foreign parent. If the former shareholders own 80% or more of the new foreign parent, then the parent will be treated for all U.S. tax purposes as a U.S. corporation under the U.S. anti-inversion laws.

backstop this main distribution rule, certain other transactions within a corporate group can be recharacterized. For example, purported debt generally would be recharacterized as equity where (1) the debt is issued to a related person for cash, (2) the issuing corporation distributes cash in excess of its "earnings and profits" to a related person (which could include a distribution to the creditor or another related entity), and (3) the debt was acquired during the period from 3 years before to 3 years after the distribution. As a result, a foreign parent that capitalizes a subsidiary with debt generally will need to do so by contributing cash and ensuring that the subsidiary does not make any distributions exceeding earnings and profits during the 6-year period spanning the creation of the debt.

If finalized in their current form, the new rules will require rigorous documentation of internal debt between a U.S. subsidiary and its non-U.S. parent. The rules will also require close attention to how the indebtedness is created, and close monitoring of cash distributions made by the subsidiary for several years before and after the creation of the internal debt. If enacted in their current form, the new rules will make it very difficult to change the leverage ratio of a subsidiary, other than at the time the subsidiary is established or is funded to make a new investment. These new rules will only be effective if finalized, and, based on the U.S. presidential election cycle, it appears that Treasury hopes to accomplish this before Labor Day 2016.

An open question is whether Treasury, in its zeal to thwart inversions, has exceeded its authority under section 385. On one hand, section 385 expressly permits bifurcation of a single instrument as part debt and part equity. On the other hand, section 385 generally authorizes Treasury only to prescribe "factors" for characterizing an instrument as debt or equity. The new rules regarding debt distributions do not clearly qualify as "factors." Depending on the resolution of this open question, as well as the general reaction to Treasury's proposals, the scope of the rules may be significantly expanded or narrowed.

Canada Update

I. Changes to Linked Notes

The 2016 federal budget (the Budget) proposes to change the tax treatment to an investor on a transfer of a linked note. As the name implies, a linked note is a debt obligation usually issued by a financial institution with a return that is linked to an index, a basket of securities or a fund. A holder of a linked note would generally not have any income inclusion prior to the maturity of the note. At maturity, the holder is required treat any return on the note as ordinary income (taxed at regular rates). Prior to maturity, a holder who transfers a note with an appreciated value would typically realize a capital gain (taxed at half regular rates) instead of ordinary income. The Budget proposes to tax the accrued gain on transfer as ordinary income instead of as a capital gain.

Types of Linked Notes

There are two main categories of notes:

Principal protected notes (PPNs): deposit notes where the issuer promises to repay the principal amount of the obligation at maturity, plus an additional amount, called a variable return, based on the performance of an underlying asset.

Principal at risk (PaR) notes or non-principal protected notes (NPPNs): PaR notes offer a potentially enhanced variable return by putting some, or substantially all, of an investor's principal at risk, based on the performance of an underlying asset during the life of the note.

Within the above two types of linked notes, many variations exist. For example:

- The reference assets can include equities, equity indices, interest rates, commodities, currencies or mutual funds.
- The variable return can be based on a multiple (accelerator notes) (say 120%) or a portion (say, 80%) of the performance of the reference fund or asset.
- The variable return can be capped or reduced after achieving a specified return.
- Issuers can have a redemption right either at various valuation dates prior to maturity (e.g., autocallables) or on a single date during the term.
- Notes, called "barrier" or "buffer" notes, can offer no loss of principal until the index falls below a specified level. However, if the index falls below that level, with barrier notes, the principal loss is the full reduction of the index, and, with buffer notes, the principal loss is only to the extent the index has fallen below the buffer level.

Held to Maturity

Linked notes are generally "prescribed debt obligations" under the relevant regulations on the basis that the return on the notes for a year depends on a future contingency (i.e., the performance of the reference index or asset). A holder of a prescribed debt obligation is required to accrue each year the maximum amount that could be payable for the year.

No interest is deemed to accrue on a typical linked note while the maximum amount of interest that could be payable under the note is indeterminable. Instead, the variable return is included in the holder's income at maturity when the variable return is determined. Canada Revenue Agency (CRA) has accepted this treatment in several advance income tax rulings. The Budget does not propose any changes to this treatment.

Secondary Market

An affiliate of the financial institution that issues the notes will generally agree that it will use reasonable efforts under normal market conditions to provide for a daily secondary market for the sale of the notes. For each series of notes, an affiliate of the issuer publishes a daily bid price at which the notes could be sold.

Notes are not typically listed on any exchange or marketplace and are therefore otherwise illiquid investments. As stated above, under existing rules, an investor who sells an appreciated note pursuant to the secondary market facility would generally realize a capital gain.

Budget Changes

Subject to certain exceptions, the Budget proposes to treat a gain realized on a sale of a linked note as interest that accrued on the note for a period prior to the transfer. The explanatory notes indicate that the measure is intended to provide symmetry between the treatment of the return on maturity and its treatment on transfer. The rule is proposed to apply to all linked notes that are sold by a holder after September 2016.

Conclusion

Linked notes are widespread and there are thousands of investors who obtain access to the markets through these products. In many cases, notes provide access to investment strategies that ordinary investors could not otherwise readily obtain. Investors can now obtain exposure to such strategies (which are tantamount to equity investments) only at the cost of ordinary income. This is particularly harsh given that any loss on a note by reason of a decline in the value of the underlying asset is recognized only as a capital loss. Investors may also require additional transitional measures to preserve capital treatment for their existing accrued gains, since they might not be able to effect cost-effective secondary sales before the end of September 2016.

II. When a Butterfly Flaps its Wings: Proposals to Tax Switches Within Mutual Fund Corporations

The Budget also introduces a proposal (the Proposal) to eliminate the perceived tax advantage available to investors of multi-class mutual fund corporations (MFCs) to switch between classes of an MFC with one investment mandate (like an equity

class) for shares of another class with a different investment mandate (like a balanced class) without immediate taxation at the time of the switch. Under the Proposal, investors switching between such classes after September 2016 will face a taxable disposition of their shares. The mutual fund industry is grappling with the impact of this change on their business model. What appears as a simple tax policy change to eliminate a potential tax deferral marketed as a "tax advantage" will have many unintended consequences.

Mutual funds are commonly structured as "mutual fund trusts" or classes of shares of a multi-class MFC. The tax treatment of mutual fund trusts and MFCs is different (see below)—and therein lies the issue.

Market Distortion

There are many billions of dollars invested in MFCs. The change will create a one-time market distortion for investors who believe they would have had one opportunity to make a final switch before becoming "locked in" to a particular strategy mix. Due to this legislative change, we expect investors may switch en masse this year—a dramatic market turn that would, if not for the new rules, not have otherwise occurred.

Less Flexibility for Long-Term Investors

The existing switch rules allowed flexibility for investors to re-allocate their portfolio among different strategies (i.e., different classes within the MFC) to react to the market. Investors with signifi-

MFCs vs. Mutual Fund Trusts

Mutual Fund Trust	MFC
Has a single investment mandate	Can have separate mandates tracking separate investment pools; permits switches between classes on a tax-deferred basis
Has nearly perfect flow-through of income and capital gains to unitholders while preserving the character of income	Taxed at corporate level (although capital gains and dividends can be flowed out to investors)
Interest, dividends and capital gains taxed in the hands of the investors with no entity-level tax imposed	Not eligible for full flow-through and the integration system between personal and corporate tax can, in some circumstances, introduce an additional tax cost

Although the proposed changes appear simple, the industry will need at least until year-end 2016 to make the necessary administrative and systems changes.

cant accrued gains face large tax burdens if they temporarily change strategies to reduce market risk in times of volatility. Investors will be faced with the choice of riding out the risk or paying tax even though they remain invested in a MFC.

Reduced Appeal

Fund companies (Managers) are concerned that investment advisers will have less incentive to put clients into an MFC and that the market share of MFCs will decline, eventually making the product uneconomic. There has been significant growth in MFC offerings in the past few years because investors liked could the flexibility to switch between Classes to re-balance their portfolio on a tax-deferred basis (even though we understand few actually did and that many holders were tax-deferred investors like RRSPs). Managers often offered MFC classes to defend against competitive pressures where other fund families had similar structures. Under the proposed new rules, the inability to switch will render MFCs generally less attractive than their mutual fund trust counterparts—and some Managers will want to migrate to avoid duplication. Since many Managers already offer separate mutual fund trusts with investment mandates similar to those of particular classes of their MFCs, those Managers will want to migrate their MFCs to mutual fund trusts—and currently, there is no ability to do this. Transitional relief will be needed to ease the transition some or all MFC classes to one or more mutual fund trusts.

Technical and Administrative Issues

Where switching occurs, there are often taxable dispositions by the MFC to re-balance its investments to the new investment strategy. In a switch, the total assets of the MFC remain the same. Accordingly, there are additional changes necessary to the capital gains refund mechanism to accommodate the income realized within MFCs that would be realized when an investor switches (and is subject to personal tax). There are also technical concerns that gains or losses that are realized as part of taxable switch will not give rise to an appropriate recognition of the underlying capital gains.

Although the Proposal appears simple, the administrative and systems changes necessary to re-code the affected MFC switches will not be ready by October 2016. The industry will need at least until year-end to reliably provide investor tax information. This timing will also allow for the change to coincide with tax year reporting, which should avoid mid-year differences in tax reporting and the potential for errors and the very messy re-filings that can ensue. We understand that the Department of Finance (Finance) is willing to work with the industry to address its concerns, and discussions are already underway with Finance to explain these implementation issues and to seek an extension of the change-over date and other relief. Ideally, Finance will permit changes to the mutual fund exchange rules to permit one or more classes of a MFC to be transferred to a mutual fund trust on a tax deferred basis.

This small change is likely to make a large impact on the industry. Investors will need to consider their long-term strategies, including if they should switch now. In the long term, investors will likely be migrated out of MFC structures by having one or more of their existing classes migrated to mutual fund trusts. This process will need to be accommodated in a seamless and simple fashion with the least amount of friction costs. The cost associated with switching reduces the efficiency of savings for investors. Given the size and complexity of the industry, will the change be worth the effort?

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“Gold Shoots” at Last for Mining Sector Financing

Michael D. Amm, Michael Pickersgill

2016 opened with the mining industry in Canada and globally facing continued challenges in the form of depressed commodity prices and difficult financing markets. While the capital markets have broadly acknowledged that commodity prices are poised to be “lower for longer,” the first half of the year has seen many commodity prices stage a partial recovery and the capital markets have rewarded some mining sector participants.

The result has been a convergence of trends that should see increased activity in the sector and a number of key questions to be answered over the balance of 2016, including whether the rebound in the gold sector will be sustained and lead to capital markets and M&A activity opening up for other commodities.

An Equity Financing Window for Some Market Players

The first half of 2016 has seen a number of companies in the gold sector raise equity in the Canadian capital markets (see Figure 1, p.48). The most significant equity financings have been completed by precious metals royalty and streaming companies. So far in 2016, Franco-Nevada, Silver Wheaton and Osisko Gold Royalties have raised over US$1.6 billion of equity capital. These financings include Franco-Nevada’s US$920 million cross-border bought deal financing completed in February, a portion of which was used to fund the acquisition of a US$500 million gold and silver stream in relation to Glencore’s Antapaccay mine in Peru, with the balance for general corporate purposes.

And it is not only the royalty and streamers who have benefited—both Kinross, a large established gold producer, and development gold companies such as Pretium Resources, Lydian Resources and Red Eagle Mining have also accessed the capital markets in 2016. For the right precious metals companies and projects, traditional equity financings may now be a more viable option as investors cautiously return.

Will Asset Sales Continue?

It remains to be seen whether the rebound in commodity prices will be sustained. A number of external factors, such as easing of concerns over Chinese growth and a dovish U.S. federal reserve helped halt the fall in commodity prices, but among commentators there is disagreement about whether this rebound in prices will keep momentum and whether a new normal has been reached. As a result, many of the themes we saw in 2015 continue to dominate. Many of the major and mid-size producers continue to pursue asset sales to address balance sheet concerns and rationalize portfolios. For example, Anglo-American

For the right precious metals companies and projects, traditional equity financings may now be a more viable option as investors cautiously return.

Figure 1. Equity Financings in 2016

Issuer	Sub-Industry	Equity Raised (in US$ millions)
Franco-Nevada Corp.	Royalty/Stream	$920
Silver Wheaton Corp.	Royalty/Stream	$632
Kinross Gold Corp.	Gold Producer	$288
Osisko Gold Royalties Ltd.	Royalty/Stream	$173
Pretium Resources Inc.	Gold Developer	$130

has announced a target of US$3-4 billion in assets sales in 2016. In addition, Freeport-McMoran has continued with its asset sale program, having recently agreed to sell its interest in the Tenke copper project in the DRC and a significant interest in it's Morenci copper mine in Arizona. Longer-term success of asset sales programs will depend on sufficient buying capacity from acquirors able to make strategic acquisitions and the availability of funds supplied by streamers and private equity investors. Equity capital markets financings may also soon become a source of funds for strategic acquirors and an option for the sellers once they have reduced debt and rationalized their portfolios.

2016 has already seen a number of gold sector companies make strategic acquisitions. In May, Goldcorp Inc. agreed to buy Canadian explorer Kaminak Gold Corp. in a C$520-million share acquisition and earlier this year, Tahoe Resources acquired Lake Shore Gold Corp. for C$550 million. Stability in commodity prices and an opening of the capital markets would make it easier for other acquirors to make acquisitions. A key question for the balance of 2016 will be whether and how this will play out.

Another "Year of the Stream"?

Streaming transactions have played a major role in the asset sale trend as streamers have had the opportunity to acquire precious metal streams on tier-one producing assets from global miners. The increased use of stream financing has spurred an evolution in stream terms to fit the needs of parties and transactions. For example, one of the key requirements of stream financings undertaken by the global miners to facilitate debt reduction is to ensure that the streams are not treated as debt by rating agencies. Certain features of the traditional structure of streaming transactions have seen ad-

justments made for this purpose—including forgoing the security interests traditionally granted over the assets and project ownership interests by the mining company.

A key question at the outset of 2016 was whether streaming companies who had largely committed their available capital through 2015 could reload their war chests and bring in financing partners to continue the pace of deals. That question has been answered in the first quarter of 2016 as these companies were able to access the equity capital markets.

Accordingly, the rest of the year ahead should see continued royalty and streaming activity, both as part of the ongoing assets sales by the large and mid-tier miners and for financing new promising projects. As these transactions continue to be driven by the traditional streamers, we expect to see private equity and institutional investors continue to show interest in participating in the streaming model.

Figure 2. Selected Streaming Deals – 2015/2016

Buyer	Seller	Project, Country	Targeted Metal	Value (in US$ millions)
Silver Wheaton Corp.	Vale S.A.	Salobo, Brazil	Gold	$900
Silver Wheaton Corp.	Glencore Plc	Antamina, Peru	Silver	$900
Franco-Nevada Corp.	Teck Resources Ltd.	Anatamina, Peru	Silver	$610
Royal Gold, Inc.	Barrick Gold Corp.	Pueblo Viejo, Dominican Republic	Gold, Silver	$610
Royal Gold, Inc.	Teck Resources Ltd.	Carmen de Andacollo, Chile	Gold	$525
Franco-Nevada Corp.	Glencore Plc	Antapaccay, Peru	Gold, Silver	$500

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Torys' Capital Markets Practice

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.

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, several of the most significant investment funds, and government agencies. We serve clients on matters across all sectors, including mining and metals, oil and gas, power, infrastructure, technology, pharma, life sciences, technology and media.

We offer high-quality coordinated cross-border services in Canada and the United States. Through our New York office, we act on U.S.-Canada and international transactions, including Rule 144A private placements, and Regulation S and Regulation D offerings; our multijurisdictional capabilities extend to our Calgary office, enabling us to give clients greater insight into, among other sectors, Canada's oil and gas markets.

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About Torys

Torys LLP is a respected international business law firm with a reputation for quality, creativity and teamwork. The firm's record of experience combined with the insight and imagination we bring to our work has made us our clients' choice for their large and complex transactions, projects and major disputes on both sides of the Canada-U.S. border and internationally.

The firm offers services in capital markets; mergers and acquisitions; litigation and dispute resolution; corporate restructuring and advisory; taxation; competition and foreign investment review; environmental; banking and debt finance; project development and finance; managed assets; private equity and venture capital; financial services; pensions and employment; intellectual property; technology; media and communications; life sciences; real estate; infrastructure; energy; mining and metals; climate change; and private client services.

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