TORYS LLP

INITIAL PUBLIC OFFERINGS IN CANADA

From kick-off to closing, Torys provides comprehensive guidance on every step essential to successfully completing an IPO in Canada.

A Business Law Guide

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INTRODUCTION

Going Public

The decision to go public is a significant milestone for a company. "Going public" refers to the process by which a private company becomes a public company. The most common procedure for going public is completing an initial public offering (IPO) of securities to the public. Generally speaking, a company completing an IPO will also apply to list its securities on a stock exchange. This guide provides an overview of the IPO process in Canada and ongoing reporting and governance requirements for public companies in Canada. The focus of this guide is on Canadian and foreign private companies rather than companies that have previously gone public in another country.[1]

Completing an IPO will often involve significant changes to a company's corporate, capital and management structures. Once public, a company will be subject to a number of rules and reporting obligations. Accordingly, the decision to go public is not one to take lightly. First, a company should focus on why it wants to go public, what its plans are and how going public will help it accomplish these plans.

Benefits and Costs of Going Public

Going public has considerable benefits:

- A value for securities can be established
- Increased access to capital-raising opportunities (both public and private financings) and expansion of investor base
- Liquidity for investors is enhanced since securities can be traded through a public market

[1] In this guide, we use the term companies to refer generally to businesses structured in various forms (including, for instance, corporations, trusts and partnerships) and the term shareholders to refer generally to the equity holders of such businesses.

- Publicly traded securities are attractive for certain other purposes (as transaction currency or executive and employee compensation, for example)

- Credibility and visibility with the public is enhanced, as is the corporate image

- Lower cost of capital relative to debt financing

Although there are many benefits, the costs of going public are considerable – for example:

- Upfront costs of an IPO can be significant. Underwriters' commissions are typically 4%–7% of the proceeds of an IPO; their expenses are additional. A company will also incur other offering expenses, including legal, accounting, printing and filing fees, and will be subject to ongoing costs associated with public company compliance obligations.

- IPOs lead to greater public disclosure and scrutiny: financial results, share price, management and director performance, executive compensation, corporate governance practices and insider trading information will all be available to the public.

- The controlling shareholders' percentage equity interest and voting interest in the company is typically lowered – a situation that, among other things, could make the company vulnerable to a control transaction.[2]

- Extensive management resources are required.

- Transaction freedom is more limited (related party transactions for a public company are regulated, and listed companies are subject to stock exchange requirements, including requirements for shareholder approval of certain matters).

- The potential for lawsuits against the directors and management is increased.

Going Public in Canada

Several unique benefits are gained by going public in Canada:

- A vibrant institutional and retail investor base exists in Canada.

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[2] For a detailed discussion on takeover bids in Canada, refer to Torys' Business Law Guide *Takeover Bids in Canada and Tender Offers in the United States: A Guide for Acquirors and Targets.*

- Canada has a strong investment culture – 50% of Canadians own shares of public companies.

- The Toronto Stock Exchange (TSX) is a well-developed market for Canadian and foreign issuers across all industries, the world's leading exchange for mining companies and includes many companies holding exclusively or primarily foreign assets.

- There is significant analyst coverage for TSX-listed companies.

- Going public in Canada can be a stepping stone to a U.S. IPO.

- A Canadian IPO is usually significantly less time-consuming and less expensive than a U.S. IPO, and

- Canadian public company compliance requirements are less onerous than U.S. requirements in some respects. For example, auditor attestations of larger companies' internal controls are mandated by the U.S. Sarbanes-Oxley Act of 2002 but are not required in Canada.

- The Canadian business environment is generally less litigious than in the United States.

The TSX is an appealing exchange for foreign companies. More than 230 foreign companies, including those from the United States, Australia, China, Israel and the United Kingdom, trade on the TSX and the TSX Venture Exchange (TSX-V). Of these, approximately 100 either were incorporated in the United States or have their principal headquarters there (see chapter 7 for information on adding a Canadian offering to a U.S. IPO).

As the TMX Group represents a dominant global market for listing the world's public mining and oil and gas companies, the TSX and the TSX-V are particularly attractive to companies of all sizes in the mining and energy sectors. These exchanges are also increasingly the market choice for small to mid-cap companies in the technology, clean-tech and industrial sectors.

A foreign company does not need to be incorporated in Canada or have Canadian operations or management to list on the TSX or the TSX-V. However, the exchanges will generally require that some members of the company's board of directors have North American public company experience.

Importance of Legal Advisers

The working group for an IPO will consist of a core team made up of the key executives from the company who will be engaged in the process; the company's outside counsel and auditors; the underwriters; and the underwriter's counsel. The

IPO process rarely proceeds from kick-off to closing without the need to respond to unforeseen developments. The IPO process is most productive and efficient when the key outside advisers – company's counsel and auditors, the underwriters, and the underwriters' counsel – are seasoned, practical and work collaboratively as appropriate. The company should consider engaging its outside counsel as a first step in the process, prior to or in conjunction with interviewing underwriters. The company's counsel should present a roadmap of the IPO process, anticipating potential roadblocks and presenting possible solutions.

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OVERVIEW OF SECURITIES REGULATION AND STOCK EXCHANGES IN CANADA

Securities Regulation in Canada

In Canada, securities regulation is a provincial and territorial matter: each of Canada's 10 provinces and three territories enacts its own securities legislation, whose requirements and structure are generally consistent. Although there is no national securities commission in Canada, the provincial and territorial securities commissions generally work together to coordinate and harmonize regulation of the Canadian capital markets through the Canadian Securities Administrators (CSA). The CSA has focused its efforts on developing uniform rules and guidelines, coordinating approval processes, developing national electronic filing systems and coordinating compliance and enforcement activities. In describing Canadian legal requirements, this guide focuses on the harmonized CSA regulations and the requirements under Ontario law, which are very similar to those of other provinces and territories.

Companies organized under Canadian corporate laws may be subject to additional requirements under those laws after they go public. However, those requirements are generally consistent with the securities law requirements described in this guide.

Where to File a Prospectus and Why

Because each province and territory has its own securities commission, a company must file a prospectus in each jurisdiction in which it wishes to offer securities to the public. National Policy 11-202, *Process for Prospectus Reviews in Multiple Jurisdictions,* provides a coordinated process for filing and reviewing prospectuses and related materials in multiple jurisdictions. Under NP 11-202, a company can access capital markets in several jurisdictions by dealing with only one securities regulatory authority, which acts as the principal regulator. In general, the principal regulator for a company will be the securities commission of the province or territory in which the company's head office is located. If a company's head office is located outside Canada, the principal regulator will be determined based on various factors, such as the location of management, assets and operations or, if these are also located outside Canada, the location of the Canadian market where the company's securities will trade; e.g., if the company's securities are being listed on the TSX, the company will likely have its closest connection to Ontario, and the Ontario Securities Commission (OSC) will be its principal regulator.

Despite the lack of a single national securities commission, most securities commissions operate under a "passport system," so that compliance with the rules and decisions of the principal regulator constitutes deemed compliance with the requirements of all other participating jurisdictions. In essence, compliance with the home province's or territory's requirements provides a passport to undertake activity in capital markets across Canada. However, there remain inefficiencies with this system. For example, Ontario, Canada's largest capital market, does not participate in the passport regime. If a securities commission outside Ontario is the principal regulator and the prospectus has also been filed in Ontario, the prospectus is known as a "dual prospectus." In this case, the principal regulator will coordinate its review with that of the OSC, and the company may have to deal separately with two securities commissions.

The CSA has developed an online system whereby prospectuses and continuous disclosure documents (such as financial statements and proxy materials) can be filed with the various securities commissions and viewed by the public. The System for Electronic Document Analysis and Retrieval, or SEDAR, provides access to all public company filings under applicable Canadian securities laws on its website <www.sedar.com>. The CSA's online system for insider reporting filings, SEDI, is described in chapter 8.

Filing a Prospectus in Quebec

As in the other provinces and territories, a company that wishes to publicly offer securities in Quebec must file a prospectus with Quebec's securities commission. However, a prospectus and any documents incorporated by reference therein filed in Quebec must be filed in French only, or with both English and French versions. The translation of documents makes filing in Quebec more expensive than filing elsewhere in Canada. Nonetheless, the general view is that costs associated with translation are outweighed by the benefits associated with access to prospective investors in Quebec.

Introduction of Cooperative Securities Regulator

Critics argue that the current system of separate provincial and territorial securities regulation fosters inefficiencies and can compromise the effective development, administration and enforcement of securities laws in Canada. Despite the substantial harmonization of many securities law requirements, companies must comply with potentially differing rules and regulatory interpretations, a situation that can be exacerbated by regulatory competition among jurisdictions. Many observers believe that the current system has also been a disincentive to foreign issuers accessing the Canadian capital markets, and to foreign investment generally.

Numerous attempts have been made by federal and provincial governments to improve the framework of securities regulation. In 2010, the federal government tabled legislation to create a national securities regulator and referred the matter to the Supreme Court of Canada for an opinion regarding its constitutional validity. In 2011, the Supreme Court determined the proposed legislation to be unconstitutional, but noted that a cooperative approach among provinces and territories to harmonize securities laws remained available. Following the Supreme Court decision, the governments of Canada, British Columbia, New Brunswick, Ontario, PEI, Saskatchewan and Yukon have agreed to establish a Cooperative Capital Markets Regulatory Authority (CMRA) to develop and oversee uniform provincial securities legislation for each participating province. A new federal law would authorize the CMRA to manage systemic risk related to capital markets in all provinces and territories (as contemplated by the Supreme Court decision) and define capital markets criminal offences. Unlike prior attempts by the federal government to create a national regulator, the CMRA is a voluntary venture among participating provinces. The CMRA is expected to be operational by 2018. Participating governments have expressed their hope that other Canadian jurisdictions will agree to join the CMRA, which could be critical to the overall success of the initiative.

In the interim, the current system continues to operate on a generally harmonized basis, with the passport system as a key feature. The fact that Canada has a multilateral system, with many securities commissions, generally has minimal impact on a public company's day-to-day operations. As a practical matter, a company will usually have to deal with only one regulator.

Stock Exchanges

The TMX Group owns and operates the TSX and the TSX-V. The TSX gives companies with an established business access to public equity, liquidity for existing and new investors and the market exposure associated with being listed on a world-class market.

The TSX-V is a public venture capital market for emerging companies, providing access to a marketplace in which these companies can raise capital to develop and market their properties, products and services. The TSX-V comprises a flexible, two-tiered system, with the potential to graduate to the senior exchange, the TSX.

Companies could also choose to list their securities on other Canadian marketplaces that have begun offering listings, such as the Aequitas Neo Exchange or the Canadian Securities Exchange, which focuses on small-cap issuers.

Listing on the Toronto Stock Exchange

A company seeking to list on the TSX must meet specified minimum financial, distribution and other standards. A company must file a listing application together with supporting data to demonstrate that the company is capable of meeting these minimum listing requirements. Further, the company must enter into a listing agreement with the TSX, committing it to comply with TSX requirements on an ongoing basis.

The minimum financial requirements and public distribution requirements vary with each category of applicant company. Applicant companies are placed in one of three categories: Industrial (General); Mining; or Oil and Gas. Special purpose issuers such as exchange traded funds (ETFs), split share corporations, income trusts, investment funds and limited partnerships are listed under the Industrial (General) category. If the primary nature of a business is not distinct, the TSX will place the company into a listing category following a review of its financial statements and other documentation. In general, an applicant company, once listed, must have at least one million freely trading public shares with an aggregate market value of at least C$4 million held by at least 300 public shareholders, each holding at least one board lot (100 shares).

An applicant company must also demonstrate that it has satisfactory management expertise and experience. This should relate not only to the company's business and industry, but also to public company experience. For a management team, companies must have at least two independent directors, a chief executive officer, a chief financial officer and a corporate secretary. The stock exchange or securities commission may undertake background searches of a company's officers and directors, either at the time of the IPO or when new members of management join the company.

At the time a company is approved for listing by the TSX, the company will be designated as either an "exempt issuer" or a "non-exempt issuer." Exempt-issuer status can be attained when the applicant company is established, has net tangible assets (or in the case of an oil and gas issuer, proved developed reserves) of C$7.5 million or more and meets prescribed cash flow, pre-tax profitability and working capital requirements. Mining applicant companies must also have proven and probable reserves capable of providing a mine life of at least three years in order to be designated as exempt. For non-exempt issuers, sponsorship is usually required and can play a significant role in determining the suitability of a company for listing on the TSX, particularly where the company only narrowly meets the minimum listing requirements for non-exempt issuers.

If the requirements for exempt status are not met at the time of original listing, the company may seek exempt status later, either on application in writing, accompanied by the applicable fee, or upon review by the TSX.

Listing on the TSX Venture Exchange

As in the case of the TSX, a company seeking to list on the TSX-V is subject to financial, distribution and other standards. An applicant company must file a listing application together with supporting data demonstrating its ability to meet the minimum listing requirements of the TSX-V. Further, an applicant company must also enter into a listing agreement with the TSX-V to uphold the ongoing requirements to maintain the listing.

The TSX-V is generally made up of emerging companies, with a focus on the resource sector. As a result, its listing requirements are aimed more toward management experience than toward a company's products and services. Applicant companies are classified into two tiers on the basis of historical financial performance, stage of business development and financial resources. Tier 1 companies have greater financial resources and are subject to more onerous minimum listing requirements than companies in tier 2, but benefit from reduced compliance obligations once listed. Tier 2 issuers comprise early-stage companies in all industry sectors, any of which can reach tier 1 status upon meeting the tier 1 minimum listing requirements.

A tier 1 company must have at least one million freely trading public shares held by at least 250 public shareholders, each holding at least one board lot and in aggregate holding at least 20% of the issued and outstanding shares. Tier 2 companies must have at least 500,000 freely trading public shares held by at least 200 public shareholders, each holding at least one board lot and in aggregate holding at least 20% of the issued and outstanding shares. Minimum quantitative requirements such as net tangible assets, working capital and financial resources are based on tier and industry sector.

An applicant company in certain categories and industry sectors may be required to submit a management plan that outlines its reasonable expectation of future revenues or a geological report to help demonstrate the company's viability. As mentioned above, sponsorship may be pivotal in determining whether an applicant company is accepted for listing on the TSX-V.

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PREPARING FOR THE IPO

Timing the Offering

Determining the appropriate time to go public is a critical decision that a company will need to make after consultation with its financial and legal advisers. A company going public should have a favourable financial history and outlook, with a clear "story" on why its securities would be an attractive investment. As part of its story, the company will need to clearly explain the intended use of proceeds of the IPO and disclose whether the proceeds will be sufficient for that stated purpose (see chapter 6 for a more detailed discussion of the use of proceeds from an IPO). The timing for an IPO is also subject to a variety of external market factors. For instance, in a general or sector-specific market downturn, financial advisers will often recommend delaying an IPO.

As an initial step in the IPO process, the company will need to select the lead underwriter, who will lead the underwriting syndicate and be actively involved in the preparation of the company's prospectus and in managing the marketing and sale of the company's securities (see chapter 5 for further information on underwriters). For simplicity in this guide, we refer to a lead underwriter in the singular, though more than one may have this role (co-leads or joint-heads).

Structuring the Offering

Well before the launch of the IPO process, several important structural questions, discussed below, must be considered.

Company Valuation

In advance of an IPO, the company should assess its expected valuation with key shareholders, other stakeholders and the lead underwriters. Valuation involves the assessment of the company's equity value, which in turn determines the potential market value of the securities to be offered. Related considerations include the number of shares to be offered, the anticipated price per share or "range" and the percentage of the company's shares to be offered to the public.

Determining Which Securities Are Being Offered

Generally, common shares newly issued from treasury are offered in an IPO. However, a company can also undertake an IPO of debt or other equity securities (e.g., preferred shares). A company can also undertake an IPO entirely or partly by way of a secondary offering, whereby selling shareholders resell some or all of their securities to the public. See "Selling Shareholders" below.

Share Structure and Public Interest Considerations

The CSA has issued a bulletin addressing share structure and related public interest issues in the context of an IPO. When a securities commission reviews an IPO by a company with a share structure that the commission considers contrary to public interest, it may refuse to issue a receipt for the prospectus. These public interest concerns may be raised in the following circumstances: (i) share structures in which the founders (which generally include a director, officer, promoter[3] or insider of the company) have paid a nominal amount for a large block of shares relative to the IPO price; and (ii) transactions in which IPO investors are to contribute an amount of capital that will be significantly disproportionate to their equity interest on completion of the IPO.

Other factors the CSA will consider when evaluating acceptable share structures include (i) the amount of time, effort and resources spent by the founders developing the business and whether this represents a realization of business development efforts or otherwise demonstrates value; (ii) the amount of cash invested by the founders and the length of time it has been actively used as part of the company's capital structure and development of its business; and (iii) the presence of significant convertible securities, which includes options, outstanding at exercise prices lower than the IPO price.

Escrow for Initial Public Offerings

In some IPOs, securities commissions require a company and its principals (as defined below) to enter into escrow agreements. These agreements align principals with new investors by restricting the principals' ability to sell securities for a period of time following the IPO. In this way, the principals have an incentive to devote their time and attention to the company's business in the post-IPO period.

Securities commissions generally do not consider escrow to be necessary for larger IPOs. Under National Instrument 46-201, Escrow for Initial Public Offerings, escrow is not required if a company, after its IPO, is classified by the TSX as an "exempt issuer" (see chapter 2) or has a market capitalization of at least C$100 million.

[3] A person or company that takes the initiative in founding, organizing or substantially reorganizing the business of a company, or who receives significant securities or proceeds in consideration of services in connection with such a transaction.

In addition, escrow is not required for a company that, following a business combination (such as a takeover bid, an issuer bid, a plan of arrangement, an amalgamation, a merger or a reorganization), is a successor to companies whose principals have been subject to escrow requirements.

Securities commissions will generally require principals of "established issuers" and "emerging issuers" to enter into a prescribed form of escrow agreement with respect to their pre-IPO security holdings. An established issuer is a company that, after its IPO, is listed on the TSX and is not classified as an exempt issuer by the TSX, or is a TSX-V tier 1 issuer. An emerging issuer is a company that, after its IPO, is not an exempt issuer or an established issuer.

Principals who may be subject to escrow requirements include the following:

- promoters of the company during the two years preceding the IPO;

- directors or senior officers of the company or of a material operating subsidiary at the time of the IPO;

- persons or companies that hold more than 20% of the company's voting securities immediately before and after the IPO; and

- persons or companies that hold more than 10% of the company's voting securities immediately before and after the IPO and have elected or appointed (or have the right to elect or appoint) one or more directors or senior officers of the company or of a material operating subsidiary of the company.

Companies controlled by one or more principals and family members sharing a principal's residence will also be treated as principals and be subject to escrow. However, a principal that holds less than 1% of the voting rights attached to the company's outstanding securities immediately after its IPO is not subject to escrow requirements.

Generally, only equity securities and securities convertible into or exchangeable for equity securities that are held by a principal prior to the IPO are subject to escrow. In certain circumstances, additional equity securities or convertible securities that are acquired by a principal may also be subject to escrow.

Non-transferable incentive stock options issued to principals that are exercisable for cash at a price equal to or greater than the IPO price are excluded from escrow.

The timing of the release from escrow will vary, depending on whether the company is an emerging or established issuer. Escrow securities of established issuers will generally be released over an 18-month period: 25% of the total number of the escrow securities will be released on the date the company's securities are listed on a stock exchange; another 25% of the escrow securities will be released 6 months after the listing date; another 25% of escrow securities will be released 12 months after the listing date; and the final 25% of escrow securities will be released after 18 months.

Principals of emerging issuers will generally have their escrow securities released over a three-year period as follows: 10% of the total number of escrow shares will be released on the listing date, and a further 15% of the escrowed securities will be released every 6 months until the last 15% is released at 36 months.

In certain circumstances, under a permitted secondary offering, a principal may sell all or any portion of the securities that it held at the time of the IPO free of escrow. This permitted secondary offering must be disclosed in the IPO prospectus and any of the principal's unsold escrow securities will continue to be subject to escrow.

The securities regulatory authorities reserve the discretion to propose alternative escrow requirements in connection with a non-exempt issuer's IPO. This discretion may be exercised, for example, if the IPO has not been underwritten or the offered securities are not listed on a stock exchange.

Selling Shareholders

Under a secondary offering, the selling shareholders use the same prospectus to sell their securities as the company uses to offer the newly issued securities. In some cases, an IPO will consist only of a secondary offering if the company itself does not require any proceeds. It is important to keep in mind that although the prospectus is prepared by the company and its advisers, selling shareholders have statutory liability for a misrepresentation in the prospectus and will be jointly and severally liable with the issuer (and certain other parties) for the full amount of the offering, without the benefit of a due diligence defence. However, to limit its potential exposure, a selling shareholder could seek indemnities from the issuer and other selling shareholders.

Underwriters typically require that key existing shareholders agree to hold their shares for a certain period of time following completion of the IPO. This ensures that the key shareholders of the company will – along with the new investors – continue to support the company and remain exposed to changes in the company's prospects for a period of time following the IPO. The duration of this "lockup period" is subject to negotiation with the underwriters, but typically it lasts 180 days.

Dual Class Structures

In some cases, a company may want to reserve control rights for its founding investors when taking the company public and will create two classes of common equity, with the founders holding multiple voting shares and the public investors holding subordinate voting shares. Alternatively, the founders may hold voting shares and the public will be offered non-voting shares. These dual class structures may not be as attractive to investors, who may find them more difficult to value and understand.

Companies with these structures may be subject to greater scrutiny by institutional investors, in particular. That said, if a compelling tax or business reason exists for adopting a more complex structure, and the reason can be clearly explained, the dual class structure may be appropriate.

The TSX and the TSX-V rules require “coattail” provisions for listed companies with dual class voting shares. These rules mandate that listed companies allow holders of subordinate or non-voting common equity to participate equally in a takeover bid with holders of superior voting shares. If a takeover bid is structured to defeat this objective, the exchange may take disciplinary measures against any person, company or listed company that is under the jurisdiction of the exchange and that is involved in making the bid. The exchange may also seek intervention from securities commissions in appropriate cases.

Reorganization and Recapitalization

Depending on a company’s existing corporate form and organization, it may be advisable to undertake a corporate reorganization ahead of a planned IPO. For example, a holding company might be created as the parent of an existing business, and the holding company will be the IPO vehicle. Tax and marketing considerations may also be relevant to the pre-IPO structuring as well as to the choice of jurisdiction in which the IPO vehicle should be organized.

Another question for a company to consider is what to do with existing preferred shares and its other outstanding shares, assuming the securities being offered are common shares. Companies will often reorganize their existing share capital before, or concurrently with, an IPO to convert outstanding equity to common shares and otherwise simplify their capital structure. In some cases, if preferred shares have previously been issued, the company’s articles or a shareholder agreement may provide that the preferred shares are to be converted into common shares upon the IPO.

Underwriters typically advise pricing an IPO in the range of C$10 to C$20 per share. A price that is too high may limit the number of potential investors, particularly retail distribution. A company may therefore need to reorganize its share capital immediately before an IPO to achieve the desired offering price per share. For instance, suppose a company has a current share capitalization of C$500 million (consisting of common shares) and wishes to issue an additional C$200 million of common shares. If the underwriters advise that C$10 per share is the ideal offering price per share for the IPO, the existing share capital may need to be reorganized so that each of the existing common shares will have a value of C$10 per share. If each existing share has a value of C$50, a company may undertake a stock split, so that each share with a value of C$50 would become five shares with a value of C$10 each.

Identifying the Required Financial Statements

Generally, audited comparative financial statements, in most cases covering the previous three completed financial years, must be included in an IPO prospectus. The prospectus must also include unaudited comparative financial statements for the most recent interim (i.e., quarterly) period.

Accounting Standards

Most companies, whether Canadian or foreign, conducting an IPO in Canada will have to prepare their financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board (IFRS-IASB). Financial statements must generally be accompanied by an auditor's report without reservation. If a company is conducting a Canada-U.S. IPO (or is already an SEC-reporting company) it will usually be able to prepare its financial statements in accordance with U.S. GAAP instead of IFRS-IASB. In such a case, no reconciliation to IFRS would be required.

A company's financial statements must usually be audited in accordance with (i) Canadian generally accepted accounting standards (GAAS), (ii) International Standards on Accounting or (iii) U.S. GAAS and the standards of the U.S. Public Company Accounting Oversight Board.

Significant Acquisitions

If the company going public has recently completed, or is likely to complete, a "significant acquisition" (as defined below), the financial statements of the acquired company must also be included in the prospectus (along with a pro forma presentation giving effect to the acquisition, in some cases). In situations like this, it makes sense to confirm the required financial statements with the company's auditors and, if appropriate, with the securities commissions through "pre-filing" discussions well in advance of going public.

An acquisition is a significant acquisition if it meets one of the following tests: (i) the Asset Test, whereby the assets of the acquired business exceed 20% of the company's assets; (ii) the Investment Test, whereby the company's investments in and advances to the acquired business as at the date of the acquisition exceed 20% of the assets of the company (excluding any pre-existing investment in or advances to the target business); or (iii) the Profit or Loss Test, whereby the profit or loss from continuing operations (excluding extraordinary items and income taxes) of the acquired business exceeds 20% of the company's profit or loss from continuing operations (excluding extraordinary items and income taxes).

Preparing for Due Diligence

As part of the IPO process, the underwriters, underwriters' counsel and company's counsel will need to conduct due diligence on the company. The purpose of the due diligence investigation is to confirm the accuracy of information in the prospectus and identify issues concerning the company, its business and its industry that must be reflected in the prospectus to ensure that it does not omit any material information.

Due diligence also allows the underwriters, the company's directors, and certain other parties to establish a defence to liability under securities laws if the prospectus contains a misrepresentation.

Business and financial due diligence is led by the underwriters and involves formal review of a company's financial statements, working capital requirements, business plans and financial forecasts, internal controls and financial reporting procedures. Site visits and contacts with key suppliers and customers may be undertaken. The underwriters will also meet with management and may conduct background searches for key personnel. The business and financial due diligence assists in the valuation process and helps identify trends, contingencies or future plans that should be reflected in the prospectus.

The legal due diligence for an IPO is an in-depth process and, depending on the company, could take several weeks to complete. It involves inquiries by the underwriters and counsel into all major aspects of the company's business, operations and corporate records. Companies should assemble their documents well in advance of a planned IPO, to be available for review in person or uploaded to an online virtual data room. In addition, corporate records and minute books should be updated if necessary.

Identifying Third-Party Consents

A company should review its material agreements to determine if any third-party consents or other approvals are required to complete the IPO. For instance, consents are often required by provisions in private company shareholder agreements or credit agreements.

In addition, confidentiality provisions in material agreements should be identified in advance so the company has adequate time to seek any necessary consents from counterparties. For instance, a company might be required to obtain consent from a supplier to name that supplier in the prospectus, or to disclose the contract to the underwriters and their legal counsel in connection with the due diligence process.

Changing the Board of Directors

A typical private company board of directors consists of a small number of individuals representing the significant shareholders and management. A typical public company has a board of directors of 5 to 12 individuals, the majority of whom are independent (i.e., not members of management or, in some cases, shareholder representatives). If the board of a public company does not have a majority of independent directors, it will need to explain how the board facilitates its exercise of independent judgment in carrying out its responsibilities. Subject to certain limited exceptions, companies will require at least 3 independent directors who are financially literate, to comprise the audit committee.

Companies planning an IPO should be looking for suitable independent director candidates well in advance of the planned IPO. The underwriters and other advisors can assist with this process, by helping to identify candidates who are expected to be well regarded by prospective investors and bring to the company complementary skills and diversity that will contribute to effective management and governance. The underwriters may undertake background searches of a company's proposed officers and directors. Detailed disclosure is required in the prospectus regarding all the directors or proposed directors of the company.

A company planning an IPO should obtain from a reputable insurer liability insurance for its directors and officers. The compensation package or retainers and fees to be offered to directors must also be settled, and disclosed in the prospectus.

Employment and Incentive Compensation Arrangements

The underwriters will want to be sure that the company has experienced management, with appropriate compensation arrangements. These arrangements should ensure stability of management in the near future and proper alignment with investors' interests.

Details of the compensation to be paid to executive officers of the company, as well as the terms of any employment agreements, will be disclosed in the prospectus. If a company already has a stock option and/or other equity-based incentive plan in effect, these plans must be amended before the IPO to ensure that they comply with applicable stock exchange requirements. Incentive grants in the six months prior to the IPO may be reviewed by the stock exchanges for compliance with applicable pricing rules. If the company does not have such a plan in effect, it is advisable to implement one before the IPO, since doing so after the IPO would require shareholder approval. The number and type of securities available and the other terms of the plans must also be disclosed in the prospectus.

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OVERVIEW OF THE IPO PROCESS

Length of Time

The length of time required to prepare and complete an IPO in Canada is generally at least 12 weeks.

Indicative IPO Timetable

The length of time to complete an IPO is influenced by numerous factors, including the company's preparedness before the IPO process, the nature and extent of the due diligence review to be completed, the state of the company's financial statements and required auditor review, market conditions and the time required to resolve comments on the prospectus made by the securities commissions. The following timetable outlines the general steps to complete an IPO. This timeline assumes that four weeks will be required to prepare the preliminary prospectus. However, additional time may be required to revise and update any available disclosure materials previously prepared by the company in the form of a preliminary prospectus, and to allow for review of the preliminary prospectus by the working group.

Contact With Media

Canadian securities commissions have formal and informal rules relating to contact with the media both before and after the filing of a preliminary prospectus. Publicity (both intentional and unintentional) that has the effect of conditioning the market for the company's securities or promoting public interest in the company is prohibited before the preliminary prospectus is available. After the preliminary prospectus is filed, the public should not be given any information other than what is contained in the preliminary prospectus. When these rules are breached, the contravention is often inadvertent. The company and its officers must implement procedures to appropriately restrict contact with the media throughout the IPO process.

Testing-the-Waters

Companies are permitted, through registered dealers (underwriters), to test-the-waters for a potential IPO by contacting accredited investors on a confidential basis to

INDICATIVE IPO TIMETABLE

Week	Task
1–2	Company selects underwriters, legal counsel, auditors and other professional advisers.
1–4	Underwriters engage in "testing the waters" discussions, on behalf of Company, with accredited investors on a confidential basis to solicit expressions of interest.[4]
1–6	Company prepares preliminary prospectus and holds related working group meetings.
1-6	Underwriters and advisers carry out due diligence review of Company.
2-6	Company begins French translation of preliminary prospectus if securities are being offered in Quebec.
6	Company's board of directors meets to approve preliminary prospectus.
6	Company files preliminary prospectus with Canadian securities commissions and issues news release. Underwriters may solicit expressions of interest from potential investors after receipt for preliminary prospectus is issued.
6	Company files listing application with TSX.
6-8	Company and lead underwriters prepare marketing materials for road show, including French translation of marketing materials if securities are being offered in Quebec.

[4] The timing of holding "testing the waters" discussions may be deferred until a substantially final draft of the preliminary prospectus or related marketing materials have been prepared and reviewed by the working group. These discussions must terminate ahead of a cooling-off period of 15 days before the preliminary prospectus is filed.

8	First comment letter is issued by principal regulator and response is prepared and submitted.
8-10	Commercial copies of preliminary prospectus are printed. Road shows and marketing begin (usually commencing after issuance of first comment letter from principal regulator).
8-10	Company begins negotiating underwriting agreement and settles all provisions except size and price of offering.
8	Company obtains conditional listing approval from TSX.
9	Second comment letter is issued by principal regulator (including comments, if any, from other Canadian securities commissions), and response is prepared and submitted.
11	Company and underwriters agree on number and price of securities to be offered (referred to as "pricing") and finalize underwriting agreement.
11	Company's board of directors meets to approve final prospectus and underwriting agreement.
11	Company files final prospectus with Canadian securities commissions and issues news release. Commercial copies of final prospectus are printed after receipt is issued. Underwriters start confirming trades.
11-12	Pre-closing and closing procedures are undertaken; shares are issued and trading begins.

Note: This timeline is a guideline only and may vary depending on particular circumstances.

solicit expressions of interest. These activities must cease for a cooling-off period of 15 days before the preliminary prospectus is filed. The issuer and underwriters must keep records of which investors were contacted and obtain written confirmations from them that they will keep the information about the offering confidential. Due to potential selective disclosure and insider trading concerns, testing-the-waters is not permitted in public offerings by companies that are already Canadian reporting issuers, that are already public in a foreign jurisdiction, or that are subsidiaries of a public company if the proposed IPO is material to the parent.

Preliminary Prospectus

The first major step for the company after selecting underwriters is to prepare a preliminary prospectus that contains full, true and plain disclosure of all material facts related to the securities to be offered. The preliminary prospectus contains the company's financial statements and information concerning, among other things,

- the business carried on by the company, including how it markets and sells its products and services, its customers, its intellectual property rights, its employees and its properties;
- the industry and markets in which the company operates and any trends affecting the company;
- the risk factors associated with the business or an investment in the company's securities;
- the officers and directors of the company and their background and skills;
- the principal securityholders of the company and the number and type of securities each principal securityholder holds;
- any material transactions of the company in the previous three years in which management and other persons related to the company had an interest;
- the issuances of the company's securities in the previous year and the prices at which the securities were issued; and
- how the company intends to use the proceeds of the IPO.

The preliminary prospectus does not typically contain the number or price of the securities to be offered in the IPO. The pricing and size of the IPO are determined after the preliminary prospectus is cleared by the relevant securities commissions and the final prospectus is ready to be filed (see "Pricing," below). There is no need to disclose a range of possible deal prices and sizes in a Canadian preliminary prospectus unless the company has provided that information in a disclosure document used in another jurisdiction. In the context of a Canada-U.S. IPO, a company would indicate the range of possible deal prices and sizes in the preliminary prospectus.

Once the preliminary prospectus is complete, it is approved by the board of directors, filed with the relevant securities commissions and formally receipted on their behalf. Staff of the principal regulator reviews the preliminary prospectus and issues written comments on it in the form of a comment letter, usually provided to the company within 10 business days of the filing of the preliminary prospectus. Subsequently, the principal regulator may provide additional comments (which would also include any comments on behalf of the other securities commissions). A preliminary prospectus is typically commercially printed after receipt of the first comment letter. The preliminary prospectus may also be distributed electronically.

Once all of the regulators' comments have been resolved, the company will produce a final prospectus (as described below) that reflects any required changes and any necessary updates from the preliminary prospectus.

Additional Documents to Be Filed with the Preliminary Prospectus

Personal information forms

In an IPO, a preliminary prospectus must be accompanied by personal information forms (a similar personal information form is required under the TSX rules) and a Freedom of Information or privacy consent from each director and executive officer of the company, fund manager and promoter. A company should consider the logistics involved in obtaining such forms well ahead of filing the preliminary prospectus.

Material contracts and other documents

Certain material contracts to which the company is a party must be described in the prospectus and filed with the securities commissions, including contracts with management (other than employment contracts); continuing contracts to purchase or sell a majority of the company's products, services or inputs; intellectual property franchise or license agreements; any credit agreements that have a direct correlation with cash distributions; any external management or administration agreements; and any contract on which the company's business is substantially dependent. Other contracts that are entered into in the ordinary course of business need not be publicly filed.

In certain circumstances, it may be possible to file redacted versions of material contracts to maintain confidentiality – for example, when an executive officer of the company has reasonable grounds to believe that disclosure of those provisions would seriously prejudice the interests of the company or would violate confidentiality provisions that the company is required to uphold.

Quiet Filing

A "quiet filing" is the name given to an IPO filing when a company requests approval from the principal regulator to pre-file a preliminary prospectus on a confidential basis and to receive and respond to the securities commission's initial comments before publicly filing the preliminary prospectus. A company pursuing a Canada-only IPO may request its principal regulator to allow the company to complete a quiet filing. The securities commission will consider what the possible prejudice would be if the company were not permitted to file on a confidential basis. Although confidential filing is possible in a Canada-only IPO, it is not a common practice.

Advantages of filing a confidential prospectus include the following:

- It allows the company to receive the first round of comments from the relevant securities commission before publicly disclosing its plans for an IPO. This practice is beneficial as it can reduce the company's public exposure during periods of market uncertainty and allows the company and underwriters to address any challenging regulatory issues or comments raised ahead of a public launch.

- If, subsequent to filing a confidential prospectus, the company decides not to proceed with the IPO, the company may terminate the offering process without having publicly disclosed any sensitive financial or business information, or even the fact that it was contemplating an IPO.

Quiet filings are expressly permitted by Canadian securities commissions only in IPOs by investment funds, upon request by the fund or its sponsor, and in certain cross-border IPOs. Refer to chapter 7 for further information about quiet filings in Canada-U.S. IPOs.

Preparation of Financial Statements

Generally, audited comparative financial statements, in most cases covering the previous three years, must be included in a prospectus for an IPO, as must unaudited comparative financial statements for the most recent interim (i.e., quarterly) period. The prospectus must also contain financial statements for the same periods for any companies that have recently been acquired or are likely to be acquired, in each case if such acquisition is a "significant acquisitions," together with a pro forma presentation giving effect to the significant acquisition. Refer to "Identifying the Required Financial Statements" in chapter 3 for further information on financial statements.

Any financial measures that are presented in the prospectus that do not conform to IFRS-IASB or other accounting standards governing the issuer's audited financial statements ("non-GAAP measures," e.g., EBITDA) must be explained and reconciled to the most comparable financial statement measure.

The Waiting Period

The time between the filing of the preliminary prospectus and the filing of the final prospectus – referred to as the “waiting period” – serves three purposes:

- to give a prospective investor an adequate opportunity to review the prospectus before entering into a binding purchase commitment;
- to allow underwriters to test the strength of the market (to establish the deal size and offering price); and
- to allow securities commissions time to review and comment on the prospectus.

During the waiting period, the company and its underwriters will be marketing the IPO. Potential investors cannot make binding commitments to buy the securities being offered under the prospectus until the final prospectus is filed. The underwriters may, however, solicit investor interest and begin to build a tentative book of orders. The marketing period for an IPO typically lasts two to four weeks. Although companies often wait for initial comments from the relevant securities commissions (which are usually provided within 10 business days of the filing of the preliminary prospectus), clearance from the securities commissions is not required before beginning marketing activities.

In Canada, marketing efforts revolve around solicitations of interest through distribution of the company’s preliminary prospectus. Until recently, the preliminary prospectus was the only written document that could be used to market an offering of securities. Securities rules now allow institutional and retail investors to be given “standard term sheets,” which contain very specific limited information, as well as more detailed “marketing materials,” once a preliminary prospectus is filed. This mirrors the approach used in the United States, where companies are permitted during the waiting period to distribute “free writing prospectuses,” which are equivalent to marketing materials in Canada. See chapter 7 for further information on marketing activities for cross-border offerings.

All information contained in any marketing materials must be disclosed in, or derived from, the preliminary prospectus, and marketing materials must contain certain prescribed legends with cautionary language noting, among other things, that they do not contain full disclosure of all material facts. All marketing materials are also required to be included in, or incorporated by reference into, the final prospectus, and filed publicly on SEDAR, with prospectus-level liability for any misrepresentations. If securities are being offered in Quebec, all marketing materials must also be filed in French.

The underwriters will also prepare a “green sheet,” which is a short document that outlines the terms of the offering by summarizing essential portions of the preliminary prospectus. It is distributed on a confidential basis to salespersons of registered dealers and is used as a reference tool and to solicit interest in the securities being offered; however, this document must not be distributed to the public.

Road Show

The road show, considered the centrepiece of the marketing process, is conducted during the waiting period.

The road show for an IPO involves members of the company's management team and the lead underwriter travelling to various cities and delivering presentations to portfolio managers, investment advisers, retail brokers, institutional investors and other potential investors. The main goal of a road show is to generate interest in the company's securities. A road show for a typical IPO will last two to three weeks.

Some road shows will include one-on-one meetings with prospective investors, but many are group meetings. The road show gives the company and the lead underwriter the opportunity to meet with potential investors and share the company's story, explain the investment highlights and answer questions. Many senior executives note that the IPO road show can be a very intense and draining experience, in part because of the number of sessions and the duration of the process. The group often visits as many as three cities per day and holds several meetings in most cities.

In addition to using the preliminary prospectus as a marketing tool, the company may use a slide show or other materials during road show presentations that will be treated as marketing materials as described above. See Chapter 7 for information on road shows in Canada-U.S. IPOs.

Many investors indicate their interest immediately after a road show stop. It is during the road show that the lead underwriter "builds a book" of investor interest in the securities to be offered. Building a book involves keeping track of the number of securities a potential investor would be prepared to purchase and at what price, based on non-binding expressions of interest. Should a satisfactory order book develop, the company and the underwriters will work together to negotiate the offering size and price for the IPO, which will be reflected in the company's final prospectus.

The success of a road show is vital to the success of an IPO – it typically has a meaningful impact on the IPO price and on initial after-market trading.

Resolving Comments From Regulators

The first comment letter on the preliminary prospectus is issued by the principal regulator without input from any other securities commission. The letter is usually divided into two sections, with general comments provided by staff lawyers and comments on the financial disclosure provided by staff accountants. The company and its advisers generally respond to the comment letter as quickly as possible to keep up momentum and to get the responses into the hands of the principal regulator before the receipt of additional comments.

All interested parties (the company, the company's auditors and counsel, and the underwriters and their counsel) must agree on the responses. The principal regulator will typically issue a second comment letter containing follow-up comments of its own and comments of any other securities commission. The company will then respond to that letter in the same way that it responded to the initial comment letter. Comments may also be discussed more informally in calls with staff lawyers and accountants. The length of time required to resolve these comments will vary, depending on the number of comments received and the nature of the issues that are raised. Given the typical duration of the marketing period for an IPO, securities commission comments can usually be settled without affecting the overall timetable.

If the securities offered by the prospectus are also being listed on a stock exchange, a copy of the preliminary prospectus will be provided to the stock exchange as part of the listing application process. Stock exchange staff separately provide comments on the parts of the prospectus covering areas that are subject to stock exchange regulation, such as management, securities-based compensation arrangements and coattail provisions (discussed in chapter 3). These comments are typically discussed and settled between the company's advisers and the stock exchange, without the involvement of the securities commissions.

Once all comments are resolved and the final prospectus is filed, the principal regulator will issue a receipt on behalf of itself and the other provincial and territorial securities commissions. The goal is to receive the receipt for the final prospectus as soon as possible.

Pricing

Toward the end of the waiting period, when the comments on the preliminary prospectus have been resolved and the underwriters have completed the marketing process and assessed the demand for the securities, the IPO will be priced. This means that the company and the underwriters will negotiate the number and price of the securities to be offered on the basis of feedback from potential investors during the marketing period and the state of the order book. Generally speaking, the company will seek the highest price that will allow the distribution of the number of securities that it wishes to offer, in view of the total proceeds it hopes to raise. The underwriters, on the other hand, will seek a price that will ensure that the IPO will be oversubscribed and that the secondary market will be strong. The final agreement as to price and quantity will be reflected in an underwriting agreement between the company and the underwriters. See chapter 5 for further information on underwriting agreements.

Final Prospectus

Any changes to the preliminary prospectus that are required as a result of securities commissions' comments will be reflected in a final prospectus, together with updated information and the number and price of the securities to be offered. The company's board of directors must approve the final prospectus. It is then filed, and the principal regulator will issue a receipt on behalf of itself and the other provincial and territorial securities commissions. Once the receipt for the final prospectus is issued, the underwriters can confirm sales to investors. The final prospectus will be commercially printed and distributed to investors or may be distributed electronically.

PREP Procedure as a Pricing Alternative

An alternative pricing method permitted under Canadian securities laws is referred to as the "post-receipt pricing procedure" (PREP procedure). With the PREP procedure, the company files the final prospectus (referred to as a "base PREP prospectus") after the regulatory review and most of the marketing activities are completed – but before pricing – leaving bullets in place of the pricing and pricing related information. Unlike the traditional pricing method described above, in a PREP procedure offering, the offering is priced and the underwriting agreement is entered into after the receipt for the final prospectus is obtained. Once the offering has been priced, no regulatory approval is needed; the company simply needs to file a "supplemented PREP prospectus" that completes all the bulleted information. The supplemented PREP prospectus must be filed within 20 days of the filing of a base PREP prospectus, although it is typically filed within a couple of days of filing the base PREP prospectus. Only limited changes can be incorporated in the supplemented PREP prospectus; generally, only pricing and pricing-related information changes can be made.

The main advantage of the PREP procedure is that it gives the company and underwriters greater flexibility regarding the pricing of an IPO and reduces the risk of additional regulatory comments, while taking advantage of market conditions and marketing opportunities. The PREP procedure is advantageous for companies completing Canada-U.S. IPOs, since it allows the company to synchronize the regulatory timing and pricing practices of the Canadian offering with that of the U.S. offering.

Withdrawal Rights

Securities legislation in certain Canadian jurisdictions gives investors the right to withdraw from an agreement to purchase securities. This right may be exercised within two business days (the "cooling-off period") of the investor receiving a prospectus and any amendment. After this right of withdrawal expires, the investor is legally bound to complete its purchase, conditional on the closing of the IPO. Since the withdrawal clock starts to run only when the investor receives the final prospectus or an amendment, there is pressure to get the final prospectus to investors as soon as possible after obtaining the prospectus receipt. In general, the closing of a Canadian IPO takes place approximately five business days after the company files the final prospectus to allow sufficient time for the investor withdrawal rights to expire.

Prospectus Amendments

During the waiting period, amendments to the prospectus may be required in certain circumstances. For instance, a material adverse change in the company's business (which thus affects the information disclosed in the preliminary prospectus) requires an amendment filing. A company may also voluntarily file an amendment or a full amended and restated preliminary prospectus to provide updated information or reflect comments received from the securities commissions before marketing begins. In addition, if any material change (adverse or otherwise) occurs in the business during the period after the final prospectus is filed and before the offering process is completed, the company must prepare an amendment and file it with the securities commissions. Amendments to a preliminary prospectus must be delivered to anyone who received the original prospectus. An amendment that is filed after the final prospectus is filed will create new rights of withdrawal for investors in respect of trades that were not completed before the date of the amendment.

Underwriting agreements generally provide that any prospectus amendment requires a notice to and approval by the underwriters. The occurrence of a material change may also delay the scheduled closing and could give the underwriters the right to terminate the underwriting agreement. See chapter 5 for further details on these termination rights, or "outs".

Closing

The closing of an IPO occurs when the company issues and sells the securities to the underwriters in return for their offering price. As previously noted, the closing typically occurs approximately five business days after the filing of the final prospectus to accommodate the investors' cooling-off period described above. The exact date of closing is negotiated and reflected in the underwriting agreement.

5

UNDERWRITERS

An important initial step for the company in the IPO process is to select underwriters. The underwriters are the company's primary link to the capital markets and public investors. The underwriters will find investors for the company's securities and will provide advice, based on their experience and knowledge of the capital markets, on many aspects of the IPO. They help determine market demand for the company's securities by working with the company to negotiate the terms, structure and pricing of the IPO, coordinating the timetable of the deal, participating in the drafting of the prospectus and marketing materials, organizing the road show and marketing the offering. They also perform due diligence on the company's business to satisfy themselves as to its quality and viability, and to protect themselves from liability for inaccurate disclosure in the prospectus.

Definition of "Underwriter"

Canadian securities laws generally define an "underwriter" as anyone who, as principal, agrees to purchase securities with a view to distribution to the public or who, as agent, offers to sell securities in connection with a distribution to the public. Underwriters are subject to registration requirements and other business conduct rules under applicable securities laws and self-regulatory organization codes.

The underwriters involved in an IPO are typically one or more registered securities dealers that purchase the offered securities from the company at a fixed price and then resell these securities to investors. However, a company may alternatively engage underwriters in an IPO to distribute securities on a "best-efforts" underwriting basis. See "Types of Underwriting – Best-Efforts Underwriting" below.

Role and Formation of the Underwriting Syndicate

Lead Underwriter or Bookrunner

The underwriter chosen by a company to manage its IPO plays a critical role in the success of the offering. The lead underwriter, or bookrunner, is actively involved in the preparation of the company's prospectus and in managing the marketing and sale of the company's securities. It is becoming increasingly common for companies to choose more than one lead underwriter, or joint bookrunners. However, the company should be aware that the lead underwriters may have differing views and approaches, and the company will need to be prepared to resolve any issues that may arise among the underwriters.

A competitive process typically determines who will be the lead underwriter. The bookrunner role involves the highest responsibility for success of the transaction and is the role most coveted by investment dealers for several reasons. This underwriter has the closest contact with the company and the highest profile among investors. The lead underwriter is listed first on the cover page of the prospectus among the underwriters participating in the transaction and also receives league table credit for the transaction.

When selecting a lead underwriter, the company should consider the following, among other things:

- Industry experience. The underwriter should have substantial experience in IPOs in the company's industry and a good familiarity with the company and its business.

- Individual investment bankers. The company should feel comfortable with the individual investment bankers assigned to the transaction. A good rapport between the bankers and management is critical.

- Reputation and attention. The underwriter's reputation is important and can help signal the prospects for the company and the credibility of the offering in the market.

- Distribution strength. The underwriter and the company should discuss who the securities should primarily be sold to – retail investors or institutional investors – and the expected allocation between those groups. The underwriters selected should have a substantial retail or institutional sales force, as required.

- After-market support. The underwriter should have a strong record of after-market price performance for the securities of the companies that it has recently taken public. A strong performance record indicates how well the underwriter priced and supported recent transactions.

- Analyst coverage. The underwriter should have a well-known analyst in the industry who shows a willingness to provide coverage of the company post-IPO. Companies contemplating an IPO typically accord great weight to securities dealers whose analyst has a high profile in the relevant sector.

The lead underwriter drives the transaction, while the broader underwriting syndicate (as described below) assists with distribution and provides after-market support. The role of lead underwriter involves providing financial advice and deal coordination, directing the due diligence processes, providing deal structuring and pricing advice, managing the underwriting syndicate, developing marketing themes, providing research coverage, targeting investors, coordinating institutional and retail distribution and providing after-market stabilization.

Engagement Letter

Once the lead underwriter has been selected, the lead underwriter and the company typically set out their agreement in an engagement letter, describing the broad parameters of what the underwriters will do in the IPO. The engagement letter generally includes the following: the process and timetable to be followed; the target offering size; the proposed underwriters' commission; how expenses will be allocated and paid; indemnities in favour of the underwriters; any alternative transaction fee (a fee paid to the underwriters if the offering is not completed and the company enters into another transaction not related to the IPO within a certain period of time); and whether there will be an over-allotment option (also referred to as a "green shoe"). The engagement letter will also set out a number of terms that are to be reflected in the definitive underwriting agreement, including the events that will allow the underwriters to terminate their engagement and the lockup restrictions that will be required of the company, management and key shareholders (see "Lockups and Blackout Periods," below).

Underwriting Syndicate

On a large IPO, the lead underwriter typically recommends an additional group of securities dealers to help distribute the securities; this group is referred to as the "underwriting syndicate." The process of selecting the syndicate members and the structure of the syndicate is a joint decision by the company and the lead underwriter to maximize the IPO's success. Companies often request that the lead underwriter include in the syndicate securities dealers with which they have a relationship or that may provide research coverage. The lead underwriter generally invites a number of underwriters to participate in the offering. In a firm-commitment underwriting, each underwriter agrees to purchase a specific allotment of the offered securities. The size of the syndicate and the economic splits within the syndicate are a function of the offering size.

The role of the broader underwriting syndicate includes providing assistance with distribution, building the profile of the offering and providing research, trading and credit support.

Underwriters and Potential Conflicts of Interest

The company should discuss with potential underwriters and assess critically any potential conflicts in the representation. Conflicts may result from an underwriter's relationship with competitors or with the company, including through prior purchases of securities or financing provided by an affiliated lender.

Types of Underwriting

The two principal underwriting arrangements are “firm-commitment underwriting” and “best-efforts underwriting.”

Firm-Commitment or Marketed Underwriting

A firm-commitment, or marketed, underwriting is based on the underwriters’ commitment, subject to certain conditions and termination rights, to buy all the offered securities at a fixed price. As described in chapter 4, before executing the underwriting agreement, the underwriters will market the IPO on a road show and solicit expressions of interest, as they “build the book.” Generally, the underwriters will not sign the underwriting agreement unless the offering is “over-subscribed” —there are expressions of interest from investors to purchase more than the number of securities being offered, thus minimizing the underwriters’ risk of holding unsold securities. If the underwriting agreement is signed, the underwriters then resell the securities to the investors who have provided expressions of interest and whose purchase orders are confirmed. Most larger IPOs are underwritten on a firm-commitment basis. This commitment made by the underwriters is subject to market conditions.

A bought-deal underwriting is a firm-commitment underwriting in which the underwriters commit to purchase securities before a prospectus is filed, without a marketing period or road show. This kind of underwriting agreement is not used in IPOs.

Best-Efforts Underwriting

In a best-efforts underwriting, the underwriters are obligated to use their reasonable best efforts to sell the company’s securities on behalf of the company. At no time do the underwriters obligate themselves to purchase the securities, as they do in a firm-commitment underwriting. The securities issued to the investors identified by the underwriters pass directly to the investor from the company without the underwriters ever taking title. The underwriters will receive a commission only for those securities sold and are not responsible for any unsold securities.

Underwriters’ Commission

An IPO involves substantial expenses. One of the major expenses is the underwriters’ commission, which can range from 4% to 7%, or more, of the total proceeds of the IPO; the underwriters’ expenses are additional. The underwriters’ commission depends on a number of factors, including the size of the IPO, the type of security offered and the listing jurisdictions, and is determined by negotiations between the underwriters and the company, with reference to market precedents.

In addition to the commission, underwriters may receive other compensation or benefits, including warrants or other equity participation, reimbursement of expenses, rights of first refusal on future underwritings, and consulting or financial advisory arrangements, as partial consideration for their participation in an IPO.

Due Diligence

Importance of Due Diligence

Due diligence is a central part of any IPO. It is a continuing process that will occur from the early stages of the IPO and continuing through the completion of the offering. Essentially, due diligence involves a detailed investigation by the company's advisers, including the underwriters, the accountants and legal counsel, into the company and its business.

As discussed in chapter 3, the purpose of the due diligence investigation is to

- confirm the accuracy of information in the prospectus and ensure the prospectus does not omit any required information;
- collect information to be discussed in further detail in formal oral due diligence sessions with the company's management, auditors and legal counsel; and
- identify issues concerning the company, its business and its industry that need to be reflected in the prospectus.

Due diligence conducted by the underwriters has additional significance: it assists the underwriters in the valuation and marketing of the company's securities and it supports the underwriters' due diligence defence under Canadian securities laws in the event of any litigation. Due diligence conducted by the company similarly assists the company's directors and officers in their due diligence defence.

Types of Due Diligence

Three main streams of due diligence are typically completed in the IPO process: business due diligence, financial due diligence and legal due diligence.

Business diligence

The underwriters conduct a business review of the company, which typically includes interviewing the company's senior management at length about its business practices; conducting on-site physical investigations at the company's properties, facilities and operations, if necessary; and interviewing the company's employees, suppliers and customers. The underwriters will assess the business with reference to their knowledge and understanding of the company's industry and its peer group issuers to ensure that the prospectus disclosure is accurate, while positioning the company from an IPO marketing perspective.

Financial diligence

Financial due diligence is led by the underwriters in coordination with the chief financial officer and the company's auditors. Among other things, it involves the analysis of the company's financial statements, working capital requirements, business plans and financial forecasts, internal controls and financial reporting procedures. The financial due diligence assists in the valuation process and helps identify trends, contingencies or future plans that should be reflected in the prospectus.

Legal diligence

Legal counsel will conduct documentary due diligence, reviewing a broad range of documents such as material contracts and other agreements, the minute books of the company and its subsidiaries, and documents relating to the ownership of real and intellectual property, any outstanding litigation issues and other corporate proceedings. On the basis of their due diligence review of the company, the underwriters and their legal counsel will seek to verify the facts and statements made in the prospectus.

In addition to supporting the facts and statements in the prospectus, the due diligence performed by legal counsel is used to support the legal opinions that both the company's counsel and the underwriters' counsel must, under the underwriting agreement, deliver to the underwriters as a condition of closing.

The Due Diligence Process

The due diligence process begins early in the course of the IPO and is a collective effort by all parties involved in the offering. Starting due diligence early in the IPO process is important to ensure that there is sufficient time to address any issues that arise. Rather than furnishing information for review in a physical data room, many companies today use virtual data rooms where documents are posted to password-protected websites maintained by reputable third-party providers.

The underwriters and their legal counsel will prepare a comprehensive due diligence request list for the company, which should be tailored according to the company's unique business, operations and risks. The company and its advisers will compile documents that respond to the request, according to their knowledge of the business and materiality thresholds that are agreed upon with the underwriters and their legal counsel. The company should expect the initial request list to be supplemented with requests for additional information as the underwriters and their legal counsel develop a better understanding of the company and its business.

Management plays an essential role in the due diligence process. A kick-off or organizational meeting with the IPO working group, with key members of management participating, will provide an overview of the business and key issues and risks, setting the stage for the due diligence investigations to follow. In addition to compiling requested documents, officers and other key employees will discuss material aspects of the business and related disclosure questions with the working group and answer follow-up questions that arise in the course of the due diligence investigations. Management should expect the underwriters or their legal counsel to request independent verification of any factual statements contained in the prospectus.

Management Due Diligence Session

Before filing both the preliminary prospectus and the final prospectus, management participates in an oral due diligence session with the underwriters. Management due diligence consists of either a face-to-face meeting or a telephone conference (typically referred to as the "due diligence meeting") attended by the company's management, legal counsel and auditors, as well as the underwriters and their legal counsel. Prospective investors are not included. During this meeting, the underwriters ask management, the company's auditors and the company's legal counsel specific questions about the company, its business and the disclosures in the prospectus. The underwriters provide a copy of the questions to the participants in advance of the meeting so that the participants have an opportunity to consider them. The company's auditors will provide the company and the underwriters with formal letters outlining the terms on which the auditors agree to participate in the due diligence process and purporting to limit any claims that may be brought against them arising from their due diligence activities.

Underwriting or Agency Agreement

The underwriting agreement sets out the respective legal obligations of the company, any promoter or selling shareholder and the underwriters in connection with an offering. In a firm commitment, or marketed, underwriting, the underwriters agree to purchase all the offered securities, at a price to be specified in the final prospectus, and agree to attempt to resell them to the public. The underwriters will receive a fee or commission per share sold as specified in the underwriting agreement. A best-efforts underwriting agreement is often referred to as an agency agreement.

As discussed above, the underwriting agreement is generally finalized and executed once the company and the underwriters agree on pricing.

Key terms in a typical underwriting agreement include the following:

- the underwriters' obligation, if any, to purchase the offered securities;
- the over-allotment option (or green shoe), if any, that allows the underwriters to purchase additional securities to cover over-allotments of securities sold at the time of the closing of the IPO;

- terms related to the underwriters' distribution obligations, including each underwriter's purchase commitment, the offering price and the jurisdictions in which the securities will be sold;
- commissions payable to the underwriters;
- indemnity provisions in favour of the underwriters, which will require the company, the promoter and the selling shareholders to reimburse them for certain liabilities, such as claims resulting from a misrepresentation in the prospectus;
- contribution provisions permitting an underwriter that is subject to a legal claim to seek reimbursement from other parties;
- various representations, warranties and covenants made by the company and any promoter or selling shareholder, including those relating to the company's business and operations and the offering;
- various conditions on the underwriters' obligation to complete the IPO (including the delivery of specific documents such as the legal opinions of counsel, as mentioned above);
- termination rights in favour of the underwriters, specifying the conditions under which they will not be obligated to proceed with the IPO, such as a material change in market conditions; and
- a blackout provision, restricting the company from selling additional securities for a specified period of time following the closing of the IPO.

Over-Allotment Option

The over-allotment option, or green shoe, has become standard in firm-commitment underwriting agreements. An over-allotment option is an option granted by the company to the underwriters to purchase additional securities in their respective percentages on the same terms on which the original securities are offered to the underwriters. The underwriters may purchase these additional securities only to satisfy over-allotments made in connection with the offering of the company's securities. The details of the green shoe are set out in the prospectus and can be up to 15% of the original number of shares offered. The option is generally made available for a 30-day period immediately following the closing of the IPO.

The over-allotment option allows the underwriters significant flexibility in managing the underwriting syndicate and providing after-market support for the securities. The underwriters will make an over-allotment, often taking orders for more than the number of securities offered under the prospectus. If the price for the securities rises and stays above the initial offering price, the underwriters will exercise the over-allotment option and buy the securities from the company at the initial offering price to fill the over-allotted investor orders. If the price does not rise or if it dips below the initial offering price at any time, the underwriters typically purchase securities in the open market, rather than through the over-allotment option, to cover the over-allotted investor orders. These purchases serve to support the price of the securities after closing. Without an over-allotment option, the underwriters' flexibility to support the share price would be limited.

Because of the potential impact on the securities in the after-market, companies should understand the concept of an over-allotment option and how the underwriters expect to use it in the IPO.

Distribution Obligations

The underwriting agreement includes provisions outlining the underwriters' distribution obligations. These provisions require the underwriters, during distribution of the company's securities to the public, to offer and sell the company's securities to the public only in those jurisdictions where such securities may be lawfully offered for sale or sold. The underwriting agreement will also specify the manner in which the securities can be marketed, the offering documents to be employed and the pricing to purchasers.

The underwriting agreement will typically also provide that if an underwriter enters into any agreement with a banking, selling or other group formed to assist in the distribution of the company's securities (in addition to sales through the underwriting syndicate), the underwriter will include similar distribution obligations in that agreement, as well as a requirement that members of the group comply with applicable securities laws.

Complete Distribution

Under a "complete distribution" clause, the underwriters agree to use their reasonable best efforts to complete the distribution of the company's securities as promptly as possible after closing and to provide the company with a breakdown of the number of securities (and any additional securities sold according to the over-allotment option) distributed in each jurisdiction. The company uses this breakdown to file required post-closing sales reports with the Canadian securities commissions.

Several Obligations

The underwriting agreement will also provide for "several" obligations of the underwriters, meaning no underwriter will be liable to the company for a default by any of the other underwriters. Certain actions or notices required by the underwriting agreement may be performed by, or provided to, the lead underwriter on behalf of the underwriting syndicate. However, certain rights or obligations are exercised by the underwriters individually (for example, the termination rights discussed below).

Indemnification

The underwriting agreement includes indemnities in favour of the underwriters, whereby the company, the promoter and any selling shareholders will be required to reimburse the underwriters for all costs and expenses incurred in connection with certain claims against the underwriters. A typical indemnification provision will require those parties to indemnify each of the underwriters from and against all losses (other than losses of profit in connection with the distribution of the company's securities), claims, damages, liabilities, reasonable costs and reasonable expenses, including all amounts paid to settle claims caused by or arising from

- any breach or default under or non-compliance with the underwriting agreement;
- any misrepresentation or alleged misrepresentation in the prospectus (including any marketing materials);
- orders, inquiries, investigations or proceedings instituted, threatened or announced by any court or regulatory authority, based upon any misrepresentation or alleged misrepresentation in the prospectus (including any marketing materials), preventing or restricting the trading in or the sale or distribution of the securities; or
- non-compliance with any requirement of any applicable securities laws.

The indemnities are typically not available for information provided by an underwriter. The market practice in Canada has not been to specify exactly what information has been provided by an underwriter (in contrast to the U.S. practice involving detailed statements to that effect, or "blood letters").

Should a claim as contemplated above be asserted against an underwriter, the underwriter will be required to notify the indemnifier, which may (or may be required to) assume the defence on behalf of the underwriter of any suit that is brought. The indemnifier may also be required to cover the underwriters' expenses, including per diem costs of the underwriters' own personnel, in respect of such claims as they are incurred.

Although the inclusion of indemnification provisions in an underwriting agreement is standard market practice, there is a risk that a Canadian court might follow the SEC's position and U.S. case law questioning the enforceability of such provisions from a public policy perspective.

Contribution

The contribution provision provides for equitable contribution in circumstances in which an indemnity provided in the underwriting agreement is claimed but held to be unavailable to, or unenforceable by, any underwriter. Should that occur, the underwriters and the company and its promoter and selling shareholders will generally agree to contribute to the aggregate of all claims and losses (other than losses of profit in connection with the distribution of the securities), consistent with the indemnity provision, incurred by the underwriters in proportions reflecting the relative benefits received by the parties and any underwriter, their relative faults and other relevant equitable considerations. No underwriter will be required to contribute an amount exceeding the underwriting commission that it received.

There are limitations on a party's entitlement to contribution. An underwriting agreement will typically provide that a party who engaged in any act of fraud, fraudulent misrepresentation or gross negligence will not be entitled to claim contribution from any other party who did not engage in such acts.

Expenses

Regardless of whether the offering is completed, IPO underwriting agreements generally provide that all expenses of or incidental to the sale of the securities or incidental to any other matters in connection with the offering shall be borne by the company. If there are selling shareholders, they will generally be responsible for their share of any underwriting fee, but may agree with the company as to the basis on which other offering expenses will be shared.

Termination Rights

The underwriting agreement will contain various termination rights, or outs, that will permit the underwriters not to complete the IPO. The underwriting agreement will provide that, on the occurrence of certain events, each underwriter is entitled to terminate its obligation to purchase the offered securities by giving written notice to that effect to the company at or before closing. Assuming that none of these outs is exercised, in a firm-commitment underwriting, the company will receive the entire net proceeds of the IPO, even if the underwriters cannot resell all the offered securities to the public.

Termination rights help manage a business risk, from the underwriters' perspective. They also have implications for the underwriters' regulatory capital, under the rules of their industry's self-regulatory organization: an underwriter will have preferable regulatory capital treatment when an underwriting commitment includes a "market out" and/or a "disaster out."

The following are typical outs:

Disaster

A disaster-out clause allows the underwriters to terminate if there develops, occurs or comes into effect or existence any event, action, state, condition or major financial occurrence of national or international consequence, or any governmental action, law, regulation, inquiry or other similar occurrence that, in the reasonable opinion of an underwriter, seriously adversely affects or may seriously adversely affect the financial markets in Canada, or the business, operations or affairs of the company and its subsidiaries, taken as a whole. The definition of the affected markets could be expanded, depending on where the company's securities trade or where the company carries on a significant part of its business.

Market Out

A market-out clause allows the underwriters to terminate when the state of the financial markets in Canada becomes such that in the reasonable opinion of an underwriter, the offered securities cannot be profitably marketed. As with the disaster-out clause, the definition of the affected financial markets may be expanded to suit the circumstances of the offering. For example, in a Canada-U.S. IPO, reference would also be made to the U.S. markets.

Material Change

A material change–out clause allows the underwriters to terminate when any material change (actual, contemplated or threatened) in the business, affairs, operations, assets, liabilities (contingent or otherwise), capital or ownership of the company occurs that, in the reasonable opinion of an underwriter,

- could reasonably be expected to result in the purchasers of a material number of the offered securities exercising their right under the relevant securities laws to withdraw from or rescind their purchase thereof or sue for damages; or

- has, or could reasonably be expected to have, a significant adverse effect on the securities' market price or value.

Regulatory

A regulatory-out clause allows the underwriters to terminate when any of the following events, in the reasonable opinion of an underwriter, adversely affects the trading in, distribution of or marketability of the offered securities:

- any inquiry, investigation or other proceeding is commenced, announced or threatened;

- any order is issued under any relevant statute or by any securities exchange or other regulatory authority; or

- any change in the law, or in the interpretation or administration of the law, takes place.

Lockups and Blackout Periods

The underwriters will normally require that the company, its major securityholders and principal officers and directors refrain from selling, monetizing or otherwise disposing of the company's securities for a specified number of days (usually 180) after the IPO without the consent of the underwriters. This restriction – often described as a blackout period when applied to the company, and a lockup when applied to management and other shareholders – will be reflected in the underwriting agreement and/or a separate agreement with affected shareholders. These restrictions are intended to protect the investors who bought securities in the IPO from market disruptions that could arise if additional securities were to be offered for sale shortly after completion of the IPO. The lockup also avoids the unattractive optics of persons close to the company disposing of securities in the period shortly following the offering.

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PROSPECTUS

General Overview and Form Requirements

The general prospectus requirements that apply to an IPO are outlined in National Instrument 41-101, General Prospectus Requirements. NI 41-101 is a comprehensive set of prospectus requirements for all public companies, including investment funds (other than mutual funds), that harmonizes and consolidates prospectus requirements across Canada.

Because the purpose of a prospectus is to allow the public to make an informed investment decision, it must contain full, true and plain disclosure of all material facts relating to the securities being distributed. In addition, the prospectus must not contain a misrepresentation. A misrepresentation is

(i) an untrue statement of a "material fact," or

(ii) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

In relation to securities being issued or proposed to be issued, a material fact is a fact that significantly affects, or would reasonably be expected to have a significant effect on, the market price or value of the company's securities. Materiality is also considered on the basis of whether information would be important to a reasonable investor making an investment decision. Canadian securities laws do not establish any financial thresholds or benchmarks for market-price impact to determine whether a particular fact is material.

NI 41-101 includes forms that specify the information to be included in a prospectus, covering matters such as

- the company's business,
- its industry and competitive environment,
- its capital structure,

- its recent acquisitions or dispositions,
- its directors and officers,
- its corporate governance practices,
- legal proceedings affecting the business, and
- risk factors associated with the business or otherwise relating to an investment in the offered securities.

The company will also include in the prospectus any other material facts or information necessary to meet the “full, true and plain disclosure” standard. A prospectus must also contain extensive financial disclosure. In most IPOs, a company will be required to disclose three years’ historical annual statements, as well as financial statements for the most recent interim (i.e., quarterly) period (in comparative presentation format). Annual financial statements included in a prospectus must be audited by an independent auditor and must be accompanied by an auditor’s report without reservations. Unaudited interim financial statements included in a prospectus must be reviewed by an independent auditor.

Telling the Story of a Company and Plain Language Drafting

It is essential that a company spend time and effort to thoughtfully prepare its prospectus in an IPO to ensure that it provides the public with a clear understanding of the company, its business and its prospects, and articulates both why the company’s securities are an attractive investment and the risks associated with that investment. The prospectus, particularly the business and industry sections, gives the company the opportunity to tell its story to the public. The company’s story includes its history, how it is performing at present and what it expects to achieve in the future.

Plain language rules apply to Canadian prospectuses and are described in the companion policy to NI 41-101. The prospectus must be written in clear, plain language, avoiding jargon and boilerplate wording. Plain language rules also apply to U.S. registration statements and prospectuses under the SEC’s plain English rules.

Use of Proceeds

Under NI 41-101, a company is required to state the estimated net proceeds to be received by the company through the IPO and to describe, in reasonable detail, each of the principal purposes (and the approximate amounts) for which the net proceeds will be used by the company. Principal purposes under NI 41-101 include the reduction or retirement of indebtedness, the acquisition of assets, and research and development of the company’s products or services.

The company is also required to disclose the business objectives that it expects to accomplish using the net proceeds of the IPO, including a description of each significant event that must occur for these objectives to be accomplished, the specific time period in which each event is expected to occur and the costs related to each event.

Additional Requirements for Mining Companies

National Instrument 43-101, Standards of Disclosure for Mineral Projects, outlines additional prospectus requirements for mining companies and governs the disclosure of scientific and technical information related to mineral projects. Under NI 43-101, a mining company must file a report in respect of its material mineral projects to support disclosure about reserves, resources and other technical information that is included in the prospectus. A mineral project includes any mineral exploration, development or production activities (and any royalty interests in any of these activities).

Any disclosure in the prospectus of scientific or technical information must be based on a technical report, which must be prepared under the supervision of a qualified person (such as an engineer or a geoscientist) who is responsible for the work conducted on the company's property and has read and approved the technical disclosure. In certain cases, the qualified person must be independent from the company. When filing a technical report, the company must also file a certificate from each qualified person responsible for preparing or supervising the preparation of the technical report. In addition, the company is required to file each qualified person's consent to the filing of the technical report and confirmation that the technical report supports the disclosure in the prospectus.

Additional Requirements for Oil and Gas Companies

National Instrument 51-101, Standards of Disclosure for Oil and Gas Activities, applies to companies that are directly or indirectly engaged in oil and gas activities. It requires additional disclosure in the prospectus with respect to oil and gas reserves. Any statement of reserves data must be accompanied by a report from an independent qualified reserves evaluator or auditor. To ensure management accountability, the statement of reserves data must also be accompanied by a report from management and the directors detailing their specific roles and responsibilities associated with the reserves statement and the accompanying evaluator's report. NI 51-101 further states that this same disclosure must be filed annually when an oil and gas company becomes a reporting issuer. The annual statement of reserves data will be included or incorporated by reference into any of the company's future prospectuses.

If the disclosure relates to anticipated results from sources that are not currently classified as resources, the company must engage a professional valuator to produce a report, which is often required to include the significant factors relevant to arriving at the anticipated results.

Different Requirements for Foreign Companies

Canadian and U.S. securities regulators have put in place the Multijurisdictional Disclosure System (MJDS). The MJDS allows eligible U.S. companies to offer their securities in Canada, and satisfy Canadian reporting requirements, on the basis of their disclosure documents prepared under the corresponding SEC disclosure requirements. As such, an existing U.S. public company could effectively launch a "Canadian IPO" on the basis of its U.S. filings and a U.S. prospectus with supplemental information to comply with Canadian prospectus requirements. Companies that have been reporting with the SEC for at least one year are able to take advantage of the MJDS if they have a public float of U.S.$75 million, are offering investment grade securities, or are offering securities guaranteed by its MJDS-eligible parent.

Similar procedures allow eligible Canadian reporting issuers to offer securities in the United States on the basis of documents prepared in accordance with Canadian requirements and reviewed by Canadian securities commissions. For a detailed discussion of the MJDS system, see Torys' Business Law Guide Raising Capital in the United States Under the Multijurisdictional Disclosure System.

Different Regime for Investment Funds

The Canadian prospectus rules differentiate between regular issuers and those that are investment funds, with a different form of prospectus and related disclosures required by applicable securities laws. Investment funds are further classified as either "non-redeemable investment funds" or "mutual funds" (whose securities are redeemable periodically on demand). The prospectus requirements for the following types of investment funds are set out in NI 41-101: non-redeemable investment funds; mutual funds that are not commodity pools or exchange-traded funds (ETFs); and labour-sponsored or venture-capital funds. Conventional mutual fund prospectuses are subject to different requirements: they are generally offered under a fund facts document, simplified prospectus and annual information form that must comply with disclosure requirements as set out in National Instrument 81-101, Mutual Fund Prospectus Disclosure. To facilitate comparability between funds, the requirements for a fund facts document and a simplified prospectus must be strictly adhered to, although there is more flexibility with respect to the disclosure in the annual information form prepared by the fund and filed with the Canadian securities commissions. There are also detailed operational requirements contained in National Instrument 81-102, Mutual Funds, with respect to issues such as investment restrictions and practices, conflicts of interest, matters requiring securityholder and regulatory authority approval, custodianship of portfolio securities and sales communications.

Forward-Looking Information

Prospectuses often include forward-looking information such as projections and forecasts about the company's future performance and plans and goals for its business. This type of information is subject to special rules under National Instrument 51-102, Continuous Disclosure Obligations. These rules also apply to the continuous disclosure documents that a public company is required to file after its IPO. "Forward-looking information" is defined as information regarding prospective results of operations, financial position and cash flows based on assumptions about future economic conditions and courses of action. Forward-looking information is classified as (i) "future-oriented financial information" (or FOFI) if it is presented in financial statement format, such as a projected balance sheet or statement of cash flows; or (ii) a "financial outlook" if it is presented in another manner. Examples of a financial outlook include expected revenues, net income, earnings per share, and research and development spending.

A company must have a reasonable basis for any forward-looking information that it discloses. In addition, any material forward-looking information must (i) be identified as such; (ii) be accompanied by a proximate caution stating that actual results may differ from the forward-looking information and identifying the material risk factors that could cause such differences; (iii) be accompanied by a proximate statement of the material factors or assumptions used to develop the forward-looking information; and (iv) include a description of the company's policy for providing updates of the forward-looking information beyond the minimum legal updating requirements. In addition to the foregoing requirements, FOFI and financial outlooks must be accompanied by disclosures (i) stating when the information was approved by management, and (ii) explaining the purpose of its inclusion with a caution that the information may not be appropriate for other purposes.

The securities commissions are of the view that future periods covered by FOFI and financial outlook must be limited to those for which the information can be reasonably estimated – which the securities commissions will generally consider to be the end of the company's next financial year (although a company whose business is characterized by predictable cash flows supported by long-term contracts for its output and consistent expenses may be able to justify a longer presentation period).

Although the Securities Act (Ontario) includes certain defences to liability for forward-looking information in a prospectus, these are not available for IPO prospectuses. Accordingly, companies conducting an IPO should carefully consider what forward-looking information is to be provided, the basis on which it is provided and its reliability, and should adhere strictly to the requirements of NI 51-102.

Prospectus Liability

A company's prospectus must contain a certificate signed by certain individuals associated with the company stating that the prospectus contains full, true and plain disclosure of all material facts relating to the securities offered. The underwriters are also required to sign a certificate stating that, to the best of their knowledge, information and belief, the prospectus contains full, true and plain disclosure of all material facts relating to the securities offered.

If the final prospectus contains a misrepresentation, the company, any promoter or selling shareholders, the chief executive officer (CEO) and chief financial officer (CFO), each director, each underwriter and certain others (including experts such as the company's auditors, in relation to the portions of the prospectus for which they are responsible) may be liable to purchasers of the securities. As previously noted, a misrepresentation is

(i) an untrue statement of a material fact, or

(ii) an omission to state a material fact that is required to be stated or that is necessary to make a statement not misleading in light of the circumstances in which it was made.

A material fact is a fact that would reasonably be expected to have a significant effect on the market price or value of the company's securities. If the prospectus contains a misrepresentation, a purchaser is deemed to have relied on the misrepresentation and has the choice of two statutory rights: to rescind the purchase or to sue for damages up to the purchase price. In the case of rescission, this remedy is available for 180 days from the date of purchase; in the case of an action for damages, this remedy is available for 180 days from the time the purchaser first had knowledge of the facts giving rise to the claim or three years from the date of purchase, whichever is earlier.

The company's CEO, CFO and directors may all be held personally liable for a misrepresentation; however, these individuals, along with the promoter, underwriters and experts, have a due diligence defence available to them.

Due Diligence Defence

Under Canadian securities law, the CEO, CFO, directors, promoters, underwriters and experts will not be liable to purchasers for a misrepresentation in the prospectus if they can establish that, after a reasonable investigation, they had reasonable grounds to believe, and did believe, that the prospectus did not contain a misrepresentation. This is the due diligence defence. One of the tasks of legal counsel is to provide advice on appropriate procedures that should be adopted in the IPO process to put the directors and officers of the company and the underwriters in the best position to assert a due diligence defence, should it be necessary.

In addition to underwriters' counsel conducting due diligence, Torys recommends that a company conducting an IPO ask its own counsel to conduct a full due diligence investigation. This will strengthen the ability of the CEO, CFO and directors of the company to rely on the due diligence defence to liability.

Role of Auditors and Comfort Letters

The role of the company's auditors in an IPO includes the following:

- undertaking the audit and review of the company's financial statements;
- reviewing certain financial disclosures contained in the prospectus;
- assisting the CFO and the underwriters in the course of the financial due diligence review of the company; and
- preparing comfort letters relating to financial statements and financial disclosures contained in the prospectus.

The company's auditors provide three types of comfort letters in the context of an IPO. The first is a comfort letter that is required, under NI 41-101, to accompany the preliminary prospectus in the typical case where the auditor's report included in the preliminary prospectus is not signed. The second type of comfort letter, the long-form comfort letter, is addressed to the underwriters, the company and its directors (and certain other parties with a due diligence defence) when the final prospectus is filed. It is described in the following paragraph. Finally, a "bring-down" comfort letter is issued to the same parties at closing, and is generally a brief letter confirming that the statements contained in the comfort letter that was provided on the filing of the final prospectus continue to be true at the time of closing.

The long-form comfort letter gives the directors of the company and the underwriters (and others with a due diligence defence) additional assurance that any information in the prospectus that is derived from the financial statements has been correctly calculated and presented. The underwriting agreement will require that the underwriters receive a long-form comfort letter and a bring-down comfort letter.

Before the final prospectus is filed, the underwriters' counsel will review it and request that the auditors provide comfort on specified numbers derived from the financial statements. If the auditors are unable to provide acceptable comfort (for example, if the information relates to operational or statistical measures), the underwriters will ask management to either provide additional backup detail on the relevant information or remove it from the prospectus.

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CANADA-U.S. IPOs

There are many advantages to conducting an IPO in Canada at the same time as a company is going public in the United States. The business, political and regulatory environments in the two jurisdictions are sufficiently similar to make cross-border IPOs quite attractive. The TSX provides an excellent opportunity for dual listing with a U.S. market, and this will allow leveraging of liquidity in both the Canadian and the U.S. marketplaces. Although Canadian and U.S. securities laws are not identical, a cross-border offering can be done fairly seamlessly, and companies that are public in both jurisdictions face only a small amount of duplicative regulation because, in most areas, they can comply with U.S. law and use their U.S. SEC filings to satisfy comparable Canadian requirements.

Coordinated Filings

When a company decides to go public in both the United States and Canada, the securities sold in the IPO will be registered with the SEC (on Form S-1 for a U.S. company and Form F-1 for a non-U.S. company) and will be qualified in Canada with a long form prospectus. The securities may then be sold to the public in both countries, with a single underwriting syndicate that includes dealers who are registered in either Canada or the United States (and who may sell in the other jurisdiction through properly registered affiliates). As noted earlier, a Canadian company that goes public in both Canada and the United States will usually be able to prepare its financial statements in either IFRS or U.S. GAAP, without a reconciliation.

Although the IPO process in Canada is generally consistent with the U.S. process, the timing of the SEC review will dictate the overall timing of a cross-border IPO. In short, adding a Canadian IPO to a U.S. IPO will generally not hold up the U.S. process, and the filings can be coordinated with relative ease. The converse is not true – adding a U.S. IPO to a Canadian IPO adds complexity and requires more time.

In general, a company will use the applicable U.S. form to draft its registration statement, including the preliminary prospectus, for its IPO in the United States, which will be filed with the SEC. Alternative pages for the Canadian preliminary prospectus, including prescribed legends and the company and underwriter certificate pages (discussed below), will be prepared and the preliminary prospectus will be filed with the relevant Canadian securities commissions. Both the SEC and the Canadian securities commissions will provide comments; however, the SEC's review and comment process takes longer than the Canadian process. Once the registration statement is filed with the SEC, the SEC provides its first comment letter in approximately 30 days (as opposed to approximately 10 business days in Canada). Further, the SEC generally provides many more comments on both accounting and legal disclosure matters. Once the company receives comments from both sets of securities commissions and the registration statement and prospectus are revised to incorporate them, the company will file the amended documents and may receive subsequent comment letters (in the SEC's case, generally within 10 days of filing). A company can expect to file two to four iterations of the preliminary prospectus with the SEC before the review is complete, the registration statement is declared effective and the final prospectus is filed with the Canadian securities commissions.

Quiet Filings

Under U.S. securities laws, a company conducting an IPO may be permitted to initially submit its U.S. registration statement (including the related prospectus) to the SEC on a confidential basis rather than as a public document via EDGAR (the Electronic Data Gathering, Analysis and Retrieval system). A confidential filing will usually be permitted for a non-U.S. company, provided it is listed on a non-U.S. stock exchange or is concurrently listing its securities on a non-U.S. securities exchange. Confidential filings are also permitted for Emerging Growth Companies (EGCs) under the U.S. Jumpstart Our Business Startups Act (JOBS Act). Generally, an EGC is a company (U.S. or foreign) with less than approximately US$1 billion in annual revenues until the fifth anniversary of its U.S. IPO. An EGC that takes advantage of the ability to file confidentially must publicly file its registration statement and all prior confidential filings at least 15 days before the commencement of a road show.

While confidential filings are not usually permitted by Canadian securities regulators, in Canada-U.S. IPOs, if the SEC is permitting a confidential filing in the circumstances described above, then the company may request approval to also pre-file its preliminary prospectus confidentially in Canada.

Additional Prospectus Content

Preparation of the content for the Canadian prospectus is relatively straightforward and the additional disclosures can either be integrated in the U.S. prospectus or prepared as a supplement that is typically referred to as a "Canadian wrap." This disclosure includes:

- a description of Canadian investors' withdrawal rights and statutory rights of action for rescission or damages;
- Canadian and foreign tax considerations for Canadian investors;

- expanded disclosure of relationships between the company and the underwriters and their affiliates;
- legends and other prescribed disclosures required by Canadian securities laws; and
- certificates of both the company and the underwriters.

The Rule 10b-5 Letter

In addition to the customary due diligence investigations, similar to those completed in Canadian IPOs and described in chapter 5, U.S. underwriters expect to receive a negative assurance letter or "10b-5 letter" (which refers to Rule 10b-5 under the U.S. Securities Exchange Act of 1934) from both the company's counsel and the underwriters' counsel as a condition of closing. These letters are viewed by U.S. underwriters as a significant component of the underwriters' due diligence record.

This 10b-5 letter is not, strictly speaking, a legal opinion; rather, it is a statement that, based principally on counsel's participation in the preparation of and discussions about the registration statement, nothing has come to their attention that would cause them to believe that the prospectus contains an untrue statement of material fact, or omits to state a material fact that was necessary in order to make any statement, in light of the circumstances under which it was made, not misleading. Counsel will want to make clear in the 10b-5 letter that they are not qualified to pass judgment on the significance of particular facts to potential investors or the likely impact of particular information on the market price of the company's securities. Furthermore, counsel will not want to express any opinion or belief regarding the expertized portions of the registration statement (such as audited financial statements or opinions of geologists regarding a company's estimated reserves).

As the 10b-5 letter is not a standard feature of a Canadian IPO, the company, the underwriters and their legal counsel (in both countries) must settle on which law firm(s) will deliver the 10b-5 letters, the nature of the diligence they will undertake for this purpose and the scope of the 10b-5 letters.

Communications with Potential Investors

Testing-the-Waters

Similar to rules under Canadian securities laws, the U.S. gun-jumping rules generally prohibit oral or written offers to sell securities to potential investors between the initiation of discussions with underwriters and the filing of a registration statement containing the preliminary prospectus, at which time marketing may begin. The JOBS Act, however, permits emerging growth companies (ECGs, which are generally companies with less than approximately US$1 billion in annual revenues) to engage in testing-the-waters through oral or written communications with certain sophisticated investors, prior to filing a registration statement with the SEC. This means that, in a Canada-U.S. IPO, if the company qualifies as an EGC, testing-the-waters will be permitted on both sides of the border – but Canadian rules require a 15-day cooling-off period before the preliminary prospectus may be filed.

The Waiting Period

Both Canadian and U.S. securities laws permit companies to distribute to potential investors, during the waiting period, term sheets and other information along with the preliminary prospectus. The 2013 rule amendments permitting the use of marketing materials in Canada made the Canadian regime substantially consistent with the U.S. regime in this respect. Thus, Canadian marketing materials are generally equivalent to what are called free-writing prospectuses in the United States. One notable difference in the context of Canada-U.S. IPOs, however, is that free-writing prospectuses cannot be used in the United States until the preliminary prospectus includes a price range.

Roadshows

As discussed in chapter 4, the slide show and other materials used in a road show in Canada (whether live or electronic and whether presented to institutional or retail investors) are treated as marketing materials. Even if investors are not given a copy to retain, these materials must be filed with Canadian securities regulators and are subject to prospectus-level liability. These Canadian rules are consistent with the SEC's treatment of electronic road shows, which is the case of U.S. IPOs filed with the SEC unless at least one bona fide version is available via the internet without restriction. However, in-person road shows are treated differently under U.S. law in that materials merely shown to investors do not have to be filed with the SEC and are not subject to prospectus-level liability because they are not considered to be free-writing prospectuses. To accommodate the conflict of laws, for Canada-U.S. IPOs that are offered and sold primarily in the United States, the Canadian securities regulators have provided an exemption to permit in-person road show materials to be filed confidentially instead of publicly on SEDAR and not to be incorporated by reference into the final prospectus. The use of this exemption is conditional on investors being granted a contractual right of action for misrepresentations in these road show materials.

Withdrawal Rights and Timing of Closing

As discussed in "Withdrawal Rights" in chapter 4, investors in certain Canadian jurisdictions have the right to withdraw from an agreement to purchase securities after receiving the final prospectus. The U.S. process differs from the Canadian process in that U.S. securities laws do not give investors a similar withdrawal right after receiving the final prospectus. The market practice in the United States is for an IPO to close three business days following the effective date of the registration statement and subsequent pricing (T+3). When a company is completing a Canada-

U.S. IPO, the preferred practice is to hold the closing five business days after pricing (T+5) to accommodate the Canadian cooling-off period.

Once a company has completed an IPO, it is a reporting issuer for purposes of Canadian securities laws, resulting in a number of ongoing reporting requirements, commonly referred to as continuous disclosure obligations. The purpose of continuous disclosure is to keep the market informed about developments in the company's business, thereby supporting informed investment decisions and maintaining investor confidence.

Venture issuers are a subset of reporting issuers. A venture issuer is typically a junior public company and generally has securities listed on one or more junior markets, such as the TSX-V, the Canadian Securities Exchange, the U.S. OTC Bulletin Board or the AIM (Alternative Investment Market) in London. Because venture issuers tend to carry on smaller-scale operations with fewer management and financial resources, they are subject to less onerous reporting requirements. For example, they are given more time to prepare and file their financial statements. As noted below, Canadian securities regulators have recently proposed certain amendments to the continuous disclosure rules that would further reduce the obligations of venture issuers after an IPO.

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LIFE AS A CANADIAN PUBLIC COMPANY

Overview

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Financial Reporting (Annual and Interim Requirements)

Annual financial statements must be filed within 90 days of a company's fiscal year-end (within 120 days for venture issuers). Included in the annual financial statements are a statement of comprehensive income, a statement of changes in equity and a statement of cash flows for the current year and for the year immediately preceding, as well as a statement of financial position as at the year-end of each of those fiscal years. The annual financial statements must be accompanied by a report of the company's independent auditor without reservation.

Interim financial statements must be filed within 45 days of the end of each of the first three quarters of the company's fiscal year (within 60 days for venture issuers). Interim statements are not required for the fourth quarter of the fiscal year. Interim statements of comprehensive income, changes in equity and cash flows must be prepared for the year-to-date interim period (with comparative statements from the corresponding interim period from the preceding year). A statement of financial position at the end of the interim period must also be filed, with a comparative statement of financial position as at the end of the preceding fiscal year-end. If an auditor has not reviewed the statements, a notice to that effect must accompany the statements. If an auditor was engaged but the review was not completed, a notice with reasons must be included. If an auditor was engaged but finds it necessary to express a reservation of opinion in its review report, the review from the auditor must be included.

Both annual and interim financial statements must be approved by the company's board of directors before being filed. Management's discussion and analysis (MD&A) is filed with the financial statements: the financial statements explain what happened during the relevant fiscal period, and the MD&A explains why it happened. The MD&A is a narrative explanation, through the eyes of management, of the company's performance during the period discussed (annual or interim). For interim periods, venture issuers are permitted to prepare and file a shorter, more streamlined quarterly highlights document instead of MD&A. The MD&A should address the company's current financial condition and prospects, the impact of industry and economic factors, the company's liquidity (that is, its ability to meet cash requirements in the short and long term) and any known trends and uncertainties that are likely to affect the company's business. Any trend or outlook disclosures are subject to the rules governing forward-looking information described in "Forward-Looking Information" in chapter 6. Any financial measures that are presented in MD&A or elsewhere that do not conform to IFRS-IASB or other accounting standards governing the issuer's audited financial statements ("non-GAAP measures," e.g. EBITDA) must be explained and reconciled to the most comparable financial statement measure.

There is substantial regulatory focus on the MD&A as a crucial part of a company's disclosure record. The securities commissions have underlined the importance of identifying and and disclosing relevant trends, risks and other material information, including matters relating to the environment, cybersecurity and corporate social responsibility The MD&A must be approved by the company's board of directors before being filed (or in the case of interim filings, the board's review can be delegated to the audit committee).

Annual Information Form

The Annual Information Form (AIF) is part of a company's annual filings and must be prepared and filed within 90 days of its fiscal year-end. (Venture issuers are not required to file an AIF.) The AIF generally describes the company, as well as its history, operations, prospects and risks (similar to the business description contained in a prospectus). The general content of an AIF includes the company's corporate structure; its three-year development; any significant acquisitions and relevant business activities (including its products and services, competitive conditions, any intellectual property, its customers and suppliers and its R&D); its officers and directors; its principal security holders; any material legal proceedings; disclosure of any management interest in recent material transactions; and its material contracts.

The presentation of the AIF tends to be more formal than the annual reports that many public companies prepare for investor relations purposes.

The AIF also supports a company's eligibility to offer securities using a short form prospectus in which information is incorporated by reference from the company's continuous disclosure filings. As noted above, venture issuers are not required to prepare and file AIFs, although they may choose to do so either to update the information available in the market or to establish their short form prospectus eligibility.

CEO and CFO Certifications

Certifications by the chief executive officer and the chief financial officer are designed to promote personal accountability by senior management for the information that public companies provide to the market. The annual and interim filings (comprising the financial statements, MD&A and AIF) must be covered by annual and interim CEO and CFO certifications. The CEO and CFO must state that they have reviewed the filings, that to their knowledge there are no untrue statements of material facts or material omissions, and that the financial information in the filings fairly presents the financial condition of the company.

The certifications must also address the company's disclosure controls and procedures (DC&P) and internal controls over financial reporting (ICFR). The DC&P certification relates to the company's internal processes for ensuring that material information moves up the management chain and ultimately gets disclosed accurately and on time; the ICFR certification deals with controls to provide reasonable assurance of the accuracy of the company's financial statements. In both cases, the CEO and the CFO must certify that the processes have been evaluated and that any material weaknesses have been disclosed in the MD&A. Venture issuers are permitted to provide more limited CEO and CFO certificates that do not include representations about these procedures and controls.

In contrast to the U.S. Sarbanes-Oxley Act requirements, the Canadian certifications do not need to be accompanied by an auditor attestation as to ICFR.

An OSC decision has effectively raised the standard applicable to the CEO of a public company who seeks to assert a due diligence defence in the face of allegations of untrue or misleading disclosure. Even if the CEO does not breach securities legislation, he or she may be held accountable by securities commissions exercising their public interest jurisdiction if the CEO is directly involved in making untrue or misleading disclosures and does not take active steps to ensure that disclosures are accurate; the due diligence defence will not be met if a CEO merely relies on the opinion of other members of management that disclosures are true.

Press Releases and Material Change Reports

If a material change occurs in the affairs of a reporting issuer, Canadian securities laws provide that the Company must immediately issue and file a news release and file a material change report within 10 days. Material change reports must be filed as the changes occur, not simply every quarter. A material change is a change in the business, operations or capital of the company that would reasonably be expected to have a significant effect on the market price or value of its securities. A material change can also include a decision by the company's senior management to make a change if they believe confirmation by the board is probable.

If the company believes that immediate disclosure of the material change would be unduly detrimental to its interests, the company has the option to keep it confidential, but it must provide a copy of the report to the relevant securities commission with written reasons for non-disclosure. It must also advise the securities commission every 10 days in writing whether it continues to believe that the information should remain confidential. The company must continue to do so either until a material change report is made public or until the decision to undertake the material change is rejected by the board of directors.

In addition, the TSX's timely disclosure policy requires listed companies to immediately issue a press release disclosing any material information concerning their business and affairs. Information may be material even if there has been no change in the business, operations or capital of the issuer, and therefore the TSX rule may compel disclosure of information that does not constitute a material change under securities laws. The TSX considers the immediate release of information to be necessary to ensure that information is promptly available to all investors and to reduce the risk of persons with access to the information engaging in illegal insider trading or tipping.

As with material change reports, the TSX requirement to disclose material information concerning the business and affairs of a listed company may be delayed and kept confidential temporarily if immediate release of the information would be unduly detrimental to the interests of the company. For example, disclosure may be considered unduly detrimental to a company's interests if (i) the release of the information would prejudice the ability of the company to complete a transaction or series of transactions that are underway; (ii) disclosure of the information would provide competitors with confidential corporate information that would be of significant benefit to them; or (iii) disclosure of information concerning the status of ongoing negotiations would prejudice the successful completion of those negotiations.

Business Acquisition Reports

Reporting issuers are required to file a Business Acquisition Report upon completion of a significant acquisition. The significance of an acquisition is measured by reference to the issuer's and target's relative assets and income and by reference to the issuer's investment in the target. Refer to "Identifying the Required Financial Statements” in chapter 3 for a fuller description of the significance tests, each of which uses a 20% significance threshold (100% for venture issuers). A BAR describes the transaction, the consideration paid, the source of funds and the issuer’s plans for the business. A BAR also includes historical financial statements for the acquired business and pro forma financial information.

Shareholder Meetings and Proxy Solicitation

A company’s constating documents or governing law will typically require annual shareholders’ meetings to address matters such as the election of the company’s directors and the appointment of auditors. Special shareholders’ meetings may also be held throughout the year to vote on other items of business. Special meetings are generally called to vote on fundamental changes, such as amending the company’s constating documents, or when the company’s directors would like to undertake a particular activity or consider a specific issue that requires shareholder approval. Although the conduct of annual and special meetings of shareholders is governed primarily by the law under which the company is organized, Canadian securities laws deal extensively with the form and content of information circulars and proxies, and the way in which companies and others communicate with shareholders in connection with proxy solicitation.

In preparation for any shareholders’ meeting, an information circular, together with the form of proxy and the notice of the meeting, must be sent to both registered and beneficial shareholders of the company. Depending on the company’s constating documents and governing corporate law, delivery may be accomplished by traditional mail, e-mail (if a shareholder has consented to electronic delivery) or website posting (also known as notice-and-access). The information circular is designed to provide relevant information on the matters to be voted on at the meeting so that shareholders can exercise their voting rights effectively. Specifically, the information circular must describe matters to be acted on at the meeting, any direct or indirect interest that directors, proposed directors, officers or major shareholders may have in those matters, any indebtedness of officers or directors owed to the company and any security ownership of management, directors and principal shareholders. When a matter to be voted on involves a related party, additional disclosure rules apply to protect minority shareholders. For example, the information circular may be required to include an independent, formal valuation, and minority shareholder approval may be needed to consummate the transaction.

The information circular for a meeting at which directors are to be elected or shareholders are to consider compensation matters must also include extensive information concerning the compensation of directors and the company’s five most highly compensated executive officers (including the CEO and the CFO) and the company’s explanation of its approach to executive compensation. This disclosure must cover all elements of the executive officers’ compensation packages, including salaries, bonuses, perks, deferred compensation, equity awards (including stock options), pension contributions and incentive compensation (including compensation that is contingent on performance). Disclosure is also required of compensation based on achievement of performance targets and potential future payouts on termination or a change of control. Shareholder advisory votes on executive compensation, also known as “say-on-pay,” are not required by Canadian securities laws, although many of Canada’s largest public companies have voluntarily adopted this practice.

Insider Reporting and Trading

Certain individuals are subject to insider reporting requirements under Canadian securities laws, including the CEO, the CFO, the chief operating officer (COO) and the directors of the reporting issuer, any 10% shareholder or major subsidiary, any person or company that is responsible for a principal business unit or function of the reporting issuer and any other insider who has access to undisclosed material information and can exercise significant power or influence over the business of the reporting issuer.

Reporting insiders must disclose their direct and indirect beneficial ownership of or control or direction over securities of the reporting issuer, together with any interests in or rights or obligations associated with “related financial instruments.” Related financial instruments include derivatives and other agreements that have the effect of altering, directly or indirectly, a reporting insider’s economic interest in or exposure to the reporting issuer. Insider reports must be filed on the System for Electronic Disclosure by Insiders (SEDI), which is Canada’s online service for the filing and viewing of insider reports. Although it is the responsibility of the reporting insider to file the required reports, some companies will, as a courtesy, make the filings on behalf of their reporting insiders.

Reports must be filed within 10 days of a person or company becoming a reporting insider. Thereafter, updating reports must be filed within five days of any change in the reporting insider’s beneficial ownership of, or control or direction over, a security of the reporting issuer, or any change in the reporting insider’s economic interest in or exposure to the reporting issuer through a related financial instrument. These changes include the insider’s purchase or sale of securities and the exercise of options, warrants or other convertible or exchangeable securities. The rules allow for delayed reporting of some transactions on an annual basis, including transactions under automatic securities purchase programs and compensation arrangements, if certain conditions are met. A reporting insider is not required to file a report if he or she does not own any securities of the reporting issuer or any related financial instrument involving a security of the reporting issuer.

Securities regulations prohibit insiders and other persons or companies in a “special relationship” with a reporting issuer from purchasing or selling securities of that issuer, or recommending or encouraging a purchase or sale, when they are in possession of material information that has not been generally disclosed to the public. In addition to insiders, persons or companies in a special relationship with a reporting issuer include employees of the issuer, persons or companies that engage or plan to engage in business or professional activity with the issuer, and affiliates or associates of the issuer. Any person who is considering a takeover bid for the securities of the reporting issuer and any person who is considering whether to become a party to a merger, amalgamation, or other similar type of business combination with the reporting issuer is also considered to have a special relationship with a reporting issuer. This group is also prohibited from informing, other than in the necessary course of business, other persons or companies of material information regarding the reporting issuer before that information has been generally disclosed (tipping). Securities and criminal laws impose harsh penalties for breaches of the rules governing insider trading and tipping – including fines, imprisonment or disgorgement of profits to the company – and grant private plaintiffs the right to sue for damages.

Early Warning Regime

Under the early warning regime (including National Instrument 62-103, The Early Warning System and Related Take-Over Bid and Insider Reporting Issues), disclosure must be made when a person becomes the beneficial owner of, or acquires control or direction over, voting or equity securities of any class of securities of any reporting issuer that, together with the securities of that class already owned, would constitute 10% or more of the outstanding securities of that class (this threshold drops to 5% if the issuer is the target of a takeover bid). For this purpose, securities convertible into such voting or equity securities within 60 days are treated as being beneficially owned. The required disclosure includes prompt filing of a news release and an early warning report within two business days of reaching the 10% threshold. The report must also state other prescribed information, including the holder's investment intent in making the purchase (for example, whether it is planning to make a formal takeover bid) and the holder's interest in related derivatives or other financial instruments. After the initial reporting requirement has been satisfied, every increase or decrease of 2% or more in the holdings of a 10% security holder and every material change in information contained in a previously filed report must similarly be reported.

A person who is required to file either an initial or a subsequent early warning report is prohibited from acquiring additional securities of the same class (or securities convertible into such class) from the time when the event giving rise to the report occurred until the expiry of one business day from the date that the relevant report is filed. This prohibition, however, does not apply to persons who already hold 20% or more of the securities of the particular class.

NI 62-103 provides for an alternative reporting regime and certain other reporting and acquisition exemptions for financial institutions and other investment managers that qualify as "eligible institutional investors," when they are not making or proposing to make a takeover bid or engage in a similar control transaction involving the company in which they hold securities.

Audit Committee and Corporate Governance

Under National Instrument 52-110, Audit Committees, every reporting issuer must have an audit committee of its board of directors to oversee its financial reporting and the audit of its financial statements. The board of directors generally delegates its responsibility over the financial reporting process to the audit committee. The purpose of the audit committee is to ensure the quality of a company's financial disclosure through effective board supervision and accountability, and thereby increase investor confidence.

An audit committee must comprise at least three directors. Its members must be financially literate – meaning the ability to read and understand financial statements that present a level of complexity of accounting issues generally comparable to those that can reasonably be expected to be raised by the company's financial statements. All audit committee members must be independent, which precludes them from having any direct or indirect material relationship with the company. (A material relationship is one that could reasonably be expected to interfere with the exercise of independent judgment. Employees of the company and employees of the company's auditor are automatically deemed to have a material relationship with the company.) Audit committee members cannot be affiliated with the company through a control relationship and cannot charge fees or receive any compensation from the company apart from compensation received for board or committee services. Some temporary exemptions from certain of these requirements may be available to a company that is undertaking its IPO.

Audit committee composition requirements are slightly less onerous for venture issuers. First, the financial literacy requirements do not apply. Second, in terms of independence, a majority of a venture issuer's audit committee members must not be executive officers, employees or control persons. The audit committee must recommend an external auditor (and its fees) to the company's board of directors. The audit committee must also have a charter setting out its duties and responsibilities (including those matters prescribed by securities laws), and it directly oversees the relationship with the auditor, including the resolution of disagreements with management. The audit committee also reviews financial statements, MD&A and earnings releases before disclosure. Further, the audit committee is responsible for establishing a process for receiving complaints about auditing or financial reporting matters (also described as whistleblowing).

Following the OSC's adoption of its Whistleblower Program, many public companies have adopted Whistleblower Policies which explicitly permit employees to report corporate wrongdoing internally, or externally to securities regulators, without fear of reprisals. Under the Ontario Securities Act, retaliation against whistleblowers is prohibited.

Generally, apart from the audit committee requirements, Canadian securities laws do not mandate the adoption of specific corporate governance practices by companies. For example, a company is not obliged to establish a board with a majority of independent members, nor is it required to separate the roles of board chair and CEO. (The board independence test is somewhat less stringent than the independence test for members of the audit committee, as discussed above. For this purpose, independent directors cannot have a direct or an indirect material relationship with the company, although receiving compensation may not be a disqualifying factor.) Rather, a company must describe in detail what governance practices it has adopted, explain why it considers those practices to be appropriate, and describe certain deviations from the best practices guidelines published by securities regulators. When establishing their corporate governance practices, companies also take into account the best practices advocated by the Canadian Coalition for Good Governance and the policies of the major proxy advisory firms, Institutional Shareholder Services and Glass Lewis.

In terms of compensation committees, reporting issuers are required to disclose the experience of each member of the committee that is relevant to his or her executive compensation responsibilities, how the company's compensation practices take risk into account and whether directors and named executive officers are permitted to hedge their equity-based compensation. The rules also require disclosure of the role of, and the fees paid to, compensation consultants, together with details of any services performed in the two most recent years.

In terms of diversity in the C-suite, reporting issuers are required to disclose information about gender diversity on the board and among senior management and directors' term limits and other board renewal mechanisms.

Liability for Misrepresentations in Secondary Market Disclosure

Public companies, their directors, their officers and certain other affiliated people may face civil liability for misrepresentations made in their continuous disclosure filings. Liability can arise from three different situations:

(i) through a misrepresentation in a document released by or on behalf of the company;

(ii) through a misrepresentation made in a public oral statement by or on behalf of the company; or

(iii) through the failure of the company to make timely disclosure of a material change.

The plaintiff is not required to prove reliance on the deficient disclosure to succeed in a secondary market misrepresentation action brought under securities legislation.

For the first scenario above, a plaintiff may bring an action for misrepresentation if the plaintiff acquired or disposed of the company's securities during the period between the time when the relevant disclosure document was released and the time when the misrepresentation in that document was corrected. In the second scenario, the plaintiff may bring an action if the plaintiff acquired or disposed of securities between the time the misrepresentation was publicly made and the time when it was publicly corrected. In the third scenario, to bring an action, the plaintiff must have acquired or disposed of the company's securities between the time when the material change should have been disclosed and the time when it actually was disclosed.

For an action relating to a misrepresentation made in a public oral statement or non-core document (core documents include MD&A, financial statements, AIFs or information circulars), the plaintiff must prove that the company or person making the misrepresentation knew of the misrepresentation at the time it was made, deliberately avoided acquiring knowledge of the misrepresentation or engaged in gross misconduct in allowing the misrepresentation to be made. The plaintiff does not have this burden of proof in the case of a misrepresentation made in a core document or in the case of a company failing to make timely disclosure of a material change.

There are, however, defences that may relieve a defendant from liability:

- A defendant will not be liable if it proves that the plaintiff acquired or disposed of the company's securities with prior knowledge of the deficient disclosure.

- A defendant may rely on a "reasonable investigation" defence if it can prove that a reasonable investigation was conducted before the deficient disclosure and, at that time, no reasonable grounds existed to believe that the relevant document or public statement contained a misrepresentation or that a failure to make a timely disclosure would occur.

- There are statutory safe harbour defences related to forward-looking information.

In addition to these defences, other aspects of the statutory secondary market liability regime are intended to protect defendants and deter unmeritorious claims, including a requirement that the plaintiff obtain leave of the court before proceeding and caps on damages that would apply in most cases other than when there has been fraud.

Overview of TSX and TSX-V Requirements

TSX

Disclosure and notification requirements

The TSX imposes certain disclosure and notification requirements on listed companies. The TSX's timely disclosure policy requires listed companies to immediately disclose any material information, with limited exceptions for confidentiality. A company must also immediately notify the TSX of any transaction involving the issuance or potential issuance of listed securities, described in further detail below. Finally, companies must notify the TSX of certain important corporate events, such as a change in head office, jurisdiction, or other charter document amendments, fiscal year-end, senior officers or directors; the adoption of a shareholder rights plan; and the declaration of dividends.

Shareholder approval requirements

For companies listed on the TSX, there are several instances in which shareholder approval will be necessary before a particular corporate action is taken. For example, the TSX requires that all security-based compensation arrangements be approved by shareholders when adopted and in some cases every three years thereafter. If an issuance of securities will materially affect control of a listed company, the TSX will generally require shareholder approval as a condition of the issuance. Shareholder approval will also generally be imposed on any transaction with insiders in which the aggregate consideration is 10% or more of the market capitalization of the company and the transaction has not been negotiated at arm's length (insiders are not eligible to participate in the vote). Similarly, private placements of listed securities, or securities that are convertible into listed securities, will require shareholder approval if (i) the price is below the allowable discount (which is 15% for securities trading above C$2 per share) or (ii) the number of securities issuable is more than 25% of the outstanding number of securities and the securities are issued at a discount to the market price.

The TSX will also require a listed company to obtain shareholder approval when acquiring another company if the listed company issues more than 25% of its outstanding shares (on a non-diluted basis) as consideration for the company acquired. This 25% threshold is the same as or similar to those of stock exchanges outside Canada, including the New York Stock Exchange and the London Stock Exchange.

The TSX requires listed issuers to adopt majority voting policies in uncontested director elections. Directors who are not elected by a majority of the votes cast in board elections are expected to tender their resignations to the board. Controlled companies do not have to implement a majority voting policy, although they will need to disclose their reasons for not doing so on an annual basis.

TSX-V

Disclosure and notification requirements

TSX-V listed companies are subject to the disclosure requirements of that exchange. As with the TSX, any material information that results in or would reasonably be expected to result in a significant change in the market price or value of any of the listed securities must typically be disclosed immediately after management becomes aware of the material information. Moreover, like the TSX, the TSX-V requires listed companies to notify the TSX-V of any transactions involving the issuance of listed securities or other important corporate events, as outlined above. Pre-clearance of news releases is required for material information relating to reverse takeovers, changes of business or other reorganizations, qualifying and reviewable transactions (including corporate acquisitions or dispositions), change of control, the release of future-oriented financial information or other operating projections, and disclosure of mineral or oil and gas reserves. If any unusual trading is detected, the company may be required to issue a news release stating, if true, that management is unaware of any undisclosed development that would explain the unusual activity. A trading halt may be ordered to allow for dissemination of a news release, if a company requests a halt and is concerned that a pending news release will affect the market value of its securities or if unusual trading activity suggests material information is not uniformly available to the public.

Shareholder approval requirements

Companies listed on the TSX-V must provide notice to the TSX-V of securities they propose to issue in a private placement. If the issuance will result in a change in control, the TSX-V will require the company to obtain shareholder approval of the private placement. Shareholder approval will also be necessary if the private placement appears to be undertaken as a defensive tactic to a takeover bid, or if it constitutes a related party transaction. A private placement is considered to be a material change in the company's business affairs; consequently, a news release must also be issued. Shareholder approval must also be obtained for any stock option plan that, together with all of the company's other previously established stock option plans or grants, could result at any time in the number of listed shares reserved for issuance under stock options exceeding 10% of the company's total issued shares. Further, shareholder approval must be obtained before any change of business or reverse takeover can occur.

About Torys LLP

Torys LLP is an international business law firm with offices in Toronto, New York, Calgary and Montréal. Torys is known for its client-focused legal excellence, providing services in a range of areas, including capital markets, mergers and acquisitions; corporate governance; proxy contests and other contest for corporate control; litigation and dispute resolution; restructuring and insolvency; taxation; competition and antitrust; environmental, health and safety; debt finance and lending; project development and finance; private equity and venture capital; managed assets; financial institutions; pension and employment; intellectual property; technology, media and telecom; life sciences; real estate; infrastructure and energy; climate change and emissions trading; and personal client services.

Torys regularly assists companies raising capital in Canada, the United States, cross-border and internationally. We advise issuers of various sizes in all industries as well as underwriters on all types of offerings, using a full range of offering structures.

Our Approach to Client Service

Torys is internationally known as a first-class, full-service business law firm. We are renowned for our professional and practical approach to problem solving, and for our strategic outlook. We focus on process and results: exceptional quality in the delivery of legal services and excellence in the legal outcome. We stress to all our people the importance of prompt, efficient, constructive and effective performance, generated in a collegial environment. Our service orientation extends to all those with whom we interact.

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