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# LIFE lessons: initial experience with the listed issuer financing exemption

**JUNE 28, 2023 13 MIN READ**

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On November 21, 2022, the Canadian Securities Administrators (CSA) brought into effect the listed issuer financing exemption (the listed issuer exemption) through amendments to National Instrument 45-106 *Prospectus Exemptions* (NI 45-106) and certain other consequential amendments. The listed issuer exemption is a prospectus exemption that allows reporting issuers with equity securities listed on a Canadian stock exchange to raise capital by filing a Form 45-106F19 *Listed Issuer Financing Document* (offering document) and distribute freely tradeable equity securities in reliance on the issuer's continuous disclosure record, subject to certain conditions outlined in NI 45-106.

On June 1, 2023, the CSA published CSA Staff Notice 45-330 *Frequently Asked Questions about the Listed Issuer Financing Exemption* (CSA Notice 45-330) to address some of the frequently asked questions regarding the listed issuer exemption. In CSA Notice 45-330, the CSA address certain key issues and questions on the listed issuer exemption, based on their observations and feedback from market participants during the approximate six-month period that the listed issuer exemption has been in effect.

This Update reviews CSA Notice 45-330 and provides commentary on our experience with financings under the listed issuer exemption.

## CSA update

In CSA Notice 45-330, the CSA make a number of clarifications about the use of the listed issuer exemption, including that

- The listed issuer exemption may not be used by an issuer in default of a securities legislation requirement.
- An issuer must have equity securities listed on a Canadian stock exchange *before* making use of the listed issuer exemption.
- In assessing the 50% dilution limit of the issuer's outstanding listed equity securities under the listed issuer exemption, any listed equity securities (i.e., common shares) that are issuable on exercise of warrants must be included when calculating dilution.
- The total dollar amount of the distribution maximum allowed to be raised within 12 months under the listed issuer exemption does not include common shares issuable on the exercise of warrants.
- The listed issuer exemption does not require a subscription agreement or risk

acknowledgement to be signed by the purchaser, but issuers may opt to have one to provide protection for themselves.

- An offering under the listed issuer exemption may be closed in multiple tranches, provided that
  1. if the issuer needs to raise a minimum offering amount in order to have available funds to meet its business objectives and liquidity requirements for a period of 12 months, this minimum offering amount must be raised in the first tranche closing; and
  2. the last tranche of the offering must close no later than the 45th day after issuing and filing the news release announcing the offering.
- The listed issuer exemption may be used to distribute flow-through shares, including charitable flow-through shares.
- The listed issuer exemption may be used for a bought deal offering, provided that
  1. the actual purchaser has all the rights contemplated under the listed issuer exemption, including statutory rights of action in the event the offering document or the issuer's continuous disclosure documents contains a misrepresentation, and will be named in the report of exempt distribution;
  2. the terms of the bought deal offering do not require the underwriter to purchase any equity securities not taken up by purchasers; and
  3. the issuer and underwriter ensure that no solicitations to purchase occur prior to the issuance and filing of the news release and the filing of the completed offering document.
- The listed issuer exemption may be used concurrently with other prospectus exemptions.
- The listed issuer exemption may not be used to distribute broker's warrants, since the listed issuer exemption may only be used to distribute equity securities or units consisting of equity securities and warrants.
- The listed issuer exemption may not be used for the issuance of securities for debt.
- The listed issuer exemption may not be used in Québec concurrently with a prospectus in other provinces, as the CSA view this as an attempt solely to avoid translation requirements that would also result in Québec purchasers having fewer rights than the purchasers purchasing under the prospectus. Unless the issuer is already a reporting issuer in Québec, to use the listed issuer exemption in Québec, the issuer simply needs to translate the offering document and the news release required by NI 45-106.

The CSA also further elaborated on how an issuer can meet the requirement that the issuer have adequate funds for its business objectives and liquidity needs for the 12 months following the distribution pursuant to the listed issuer exemption. In determining whether an issuer has sufficient funds, the CSA note that an issuer should take into consideration the business objectives, milestones and related costs that it is required to disclose in the offering document, as well as its current cash flow from operations and any likely future changes to that cash flow. The issuer should also take into account the costs of the offering (including selling commissions, fees and any other offering costs), the issuer's working capital or deficiency and the fact that any additional funding (including funds from a concurrent bought deal or an available credit facility) must be committed to be considered as part of the available funds. If the funds to be raised will not cover all of the issuer's business objectives and liquidity requirements for a period of 12 months, the issuer should increase the minimum offering amount.

## Additional considerations

The junior issuer market has been quick to embrace the listed issuer exemption as a way to facilitate smaller offerings of free trading securities. The listed issuer exemption has been adopted in a variety of different types of offerings, including non-brokered private placements, brokered best efforts agency offerings and even bought deals. Interestingly, while one of the impetuses for the listed issuer exemption was to help issuers avoid large discounts to market pricing driven by a four-month hold period imposed by regulatory requirements, pricing pressures do not seem to have changed very much. However, it has given issuers a greater ability to push back on the inclusion of warrants in financings as an incentive to investors to counter this four-month hold period. It should be noted that, for the most part, market conditions have been terrible for junior issuers since the listed issuer exemption was adopted, so the long-term effect on issuers raising capital will need further time and analysis.

CSA Notice 45-330 was helpful and timely to assist issuers and dealers with some of the questions that have arisen with offerings under the listed issuer exemption. Set out below are other considerations based on the CSA's guidance and our experience to date.

### 50% dilution limit

A common question for listed issuer exemption offerings was how to calculate the dilution limit, and in particular whether share purchase warrants offered in a unit offering needed to be counted towards the maximum dilution permitted under the listed issuer exemption. NI 45-106 refers to a maximum increase in "listed equity securities", which means securities of a class of equity securities listed on a recognized stock exchange. There is no reference to securities exercisable into listed equity securities, which suggested that only common shares (assuming that is the only class of securities listed) needed to be included for purposes of determining dilution. However, CSA Notice 45-330 provides that warrants or other convertible securities should be included for determining dilution.

It should be noted that warrants or convertible securities are not included for purposes of determining the maximum amount of proceeds allowed to be raised within 12 months for an offering under the listed issuer exemption.

### No pre-marketing

Pre-marketing is a sensitive topic for junior issuer financings. It is common for issuers to have discussions with potential investors prior to announcing a financing in order to have confidence that it will be a success. The listed issuer exemption strictly prohibits any solicitation to purchase prior to the issuance and filing of the news release and filing of the completed offering document. This means that the terms and structure of the offering must be fully organized prior to any public announcement and the commencement of any marketing efforts.

If the offering is a brokered offering, this means that the dealer and the issuer need to have fully considered investor participation prior to launching the offering. The engagement letter setting out the offering terms will also need to be executed by the dealer and issuer prior to any solicitation to purchase.

CSA Notice 45-330 noted that the regulators do not consider the listed issuer exemption to be available for a "shares for debt" distribution because it would require the issuer to engage with the creditor prior to the announcement of the offering and to note the limitations of the

listed issuer exemption for bought deals, which suggests a strict interpretation of the pre-marketing restriction.

This bears further review as the listed issuer exemption seems to be at odds with typical market practice.

## Offering document

The policy rationale underlying the offering document is that the listed issuer exemption is intended to rely in large part on the issuer's past continuous disclosure record to support the distribution of free trading securities. The listed issuer exemption relies on a simplified, condensed offering document, as opposed to the greater detail and breadth of disclosure involved in a prospectus. However, the offering document is not as simple as it may seem. Issuers cannot incorporate any disclosure documents by reference (unlike a short form prospectus), so issuers must ensure that they strictly comply with the form requirements of the offering document. For example, the listed issuer exemption requires disclosure of recent developments, just as with a short form prospectus. But with no ability to incorporate by reference, issuers need to assess the offering document as a standalone disclosure document, which may mean adding additional disclosure.

The offering document also requires detailed and fulsome disclosure on the use of available funds. This includes a detailed breakdown of how the issuer will use the available funds and a description of each of the principal purposes, with approximate amounts. This is similar to the level of disclosure required to describe the use of proceeds of an offering in a prospectus, and requires more detail than would normally be the case for most prospectus-exempt offerings.

Issuers are also reminded that in the event of a misrepresentation in the offering document, purchasers have a recission right and rights to damages against the issuer, regardless of whether the purchaser has relied on the misrepresentation.

## Working capital requirements

An eligibility requirement for the listed issuer exemption is that the issuer reasonably expects to have available funds to meet its business objectives and liquidity requirements for a period of 12 months following completion of the listed issuer exemption offering. Securities regulators are reviewing offering documents and disclosure records to confirm this requirement. This means that issuers must ensure that their use of available funds addresses a period of at least 12 months to ensure that the listed issuer exemption is still available for the issuer.

## Subscription agreement

The CSA note that though a subscription agreement or a risk acknowledgment to be signed by the purchaser is not required, issuers may find it in their best interests to consider using a subscription agreement which includes representations, warranties, acknowledgements and covenants of the purchaser regarding the purchaser's status and eligibility, compliance with local securities laws, acknowledgments of investment risk, reliance on prospectus exemptions and indirect collection of personally identifiable information, among others. This form of subscription agreement would be similar to the form of subscription agreement that issuers typically use in any other prospectus-exempt offering.

Another approach that has been utilized is to include the representations, warranties,

acknowledgements and covenants directly into the offering document as an appendix or schedule, as deemed representations, warranties, acknowledgements and covenants of the purchaser. This approach would be analogous to the deemed representations, warranties, acknowledgements and covenants of the purchaser included in an offering memorandum. Issuers could consider also having a simple one-page subscription agreement that is signed by the purchaser, which would act to document the subscription and ensure privity of contract with the purchaser.

The approach taken by an issuer will largely depend on the terms of the offering and the types of purchaser representations, warranties, acknowledgements and covenants that would be required or desired by the issuer in connection with the offering. For example, if the offering involves sales in foreign jurisdictions or flow-through shares, additional representations, warranties, acknowledgements and covenants of the purchaser may be sought by the issuer, in which case using a subscription agreement may be preferable.

## TSX Venture Exchange hold period

It should be noted that securities issued by TSX Venture Exchange (TSX-V) listed issuers under the listed issuer exemption may not be truly free trading if they are subject to a TSX-V hold period.

The TSX-V imposes a four-month restriction period on certain listed shares (or securities exchangeable into listed shares) issued, including those issued to

1. directors, officers and promoters;
2. consultants; and
3. anyone holding more than 10% of the voting rights attached to the issuer's securities.

The same restriction applies to stock options granted with an exercise price less than the market price, and securities issued at less than $0.05 if not qualified by a prospectus or issued under a rights offering. Securities subject to a TSX-V hold period must bear an exchange legend indicating as such in accordance with the policies of the TSX-V.

## Sales in United States and foreign jurisdictions

As the listed issuer exemption is a relatively new prospectus exemption, how jurisdictions outside of Canada will characterize this exemption with consideration to local securities laws remains somewhat unsettled.

For example, in the United States, the offering document may be characterized as akin to a prospectus and require a U.S. private placement memorandum (a U.S. wrapper) in order to offer to U.S. purchasers. In other foreign jurisdictions, issuers may run into additional and cumbersome requests from purchasers and dealers, such as for a legal opinion on compliance with local laws with respect to the offering document.

We anticipate that the market will gain more comfort with the listed issuer exemption going forward, which will result in greater certainty. However, issuers should not assume that foreign jurisdictions will treat listed issuer exemption offerings as private placements under their local rules. Issuers should consider these potential issues and engage with their legal advisors when initially determining the jurisdictions where the offering using the listed issuer exemption will be conducted.

## Combining with other offerings and selecting jurisdictions

CSA Notice 45-330 specifically notes that issuers cannot use the listed issuer exemption in Québec alongside a prospectus filed in other jurisdictions solely to avoid translation requirements. However, where an issuer is not a reporting issuer in a local jurisdiction, it is possible to carry out an offering in the local jurisdiction by way of the listed issuer exemption while carrying out a concurrent prospectus offering in jurisdictions where the issuer is a reporting issuer. This is helpful where the issuer has filed a shelf prospectus and wishes to avoid the delay required to add new jurisdictions to a shelf. However, it is important to determine the offering jurisdictions in advance to be able to comply with the requirements of the listed issuer exemption, notably the restriction from pre-marketing. Given the position of the Autorité des marchés financiers set out in CSA Notice 45-330, presumably combining a listed issuer exemption offering in Québec with a prospectus offering outside of Québec will be subject to greater scrutiny, even if the issuer does not believe that the sole reason for structuring the offering in this way was to avoid translation requirements.

## Dealers

As with most other prospectus exemptions, statutory liability is not imposed on dealers involved in offerings under the listed issuer exemption, and the dealers do not sign the offering document. The CSA note that they expect that registered dealers will still perform due diligence on the issuer and its disclosure in order to meet the dealer's suitability obligations under applicable securities legislation, which includes know-your-client and know-your-product requirements. Registered dealers may also be subject to common law liability and reputational risk in connection with their participation in the offering. Accordingly, dealers involved in an offering using the listed issuer exemption should conduct the appropriate due diligence review on the issuer, including a review of the issuer's continuous disclosure documents and corporate records, as well as due diligence sessions with management, among others.

The key issue for brokered financings using the listed issuer exemption is that the timing is a somewhat different than with typical brokered private placements. The dealer will need to start its due diligence review earlier than it otherwise might in order to meaningfully contribute to the offering document and assess the adequacy of disclosure. The additional disclosure about the offering that is set out in the offering document (which is typically more than what would be set out in a news release announcing a financing) also requires the dealer to confirm logistics for the offering earlier than it might otherwise. The pre-marketing restriction is also a key concern for dealers as no market check will be available.