

How to Get it Right – Increased Use of Rights Offerings Leads to New Guidance by the CSA

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Issuing securities through prospectus-exempt rights offerings is on the rise in Canada. The recent [Staff Notice 45-323](#) (the “**Staff Notice**”), *Update on Use of the Rights Offering Exemption in National Instrument 45-106 – Prospectus Exemptions* from the Canadian Securities Administrators (the “**CSA**”) indicates that the use of rights offerings has increased significantly since the repeal of the old rights offering rules found in National Instrument 45-101 *Rights Offerings* (the “**Old Rules**”) and the adoption of the new rules (the “**New Rules**”) now found in Section 2.1 of National Instrument 45-106 *Prospectus Exemptions*, which came into effect on December 8, 2015.

The Staff Notice indicates that during the first year following adoption of the New Rules, reporting issuers’ use of prospectus-exempt rights offerings had more than doubled. However, the CSA also noted key disclosure issues related to rights offerings under the New Rules. The identification of these disclosure issues comes on the heels of an earlier CSA staff notice that raised similar concerns in January 2017.¹

The New Rules

As the CSA views rights offerings as a potentially fair and efficient way for public companies to raise capital, in adopting the New Rules, the CSA sought to reduce the regulatory burden associated with conducting such offerings under either the Old Rules or pursuant to a prospectus.

For a detailed overview of the New Rules, please refer to our previous bulletin “[Getting it Right : CSA Amends the Prospectus-Exempt Rights Offering Regime.](#)” For convenience, the key elements of the New Rules are also set out in the table found at the end of this article.

Use of Rights Offerings

The Staff Notice reports that since the New Rules came into effect, prospectus-exempt rights offerings have been used by 23 venture issuers and seven TSX-listed issuers.

One of the major benefits of rights offerings under the New Rules is the expedited time frame for completion of such offerings. Prior to the adoption of the New Rules, the CSA found that the average length of time to complete a prospectus-exempt rights offering was 85 days. This has now decreased to 38 days under the New Rules from the time the notice of the offering is filed. However, as noted in our previous bulletin referenced above, issuers must build into their offering timeline the prior approval of the stock exchange upon which the securities of the issuer are listed.

¹ CSA Staff Notice 45-322, Potential Concerns with the Structure of Rights Offerings (January 12, 2017)

In their review of 30 rights offerings conducted in the first year following adoption of the New Rules, the CSA also noted the following trends:

- 57% of rights offerings under the New Rules involved a stand-by commitment and 88% of such commitments were entered into by insiders or related parties of the issuer;
- on average, issuers sought to issue 50.65% of the outstanding securities of the applicable class through the rights offering and actually issued an average of 39% of the outstanding securities; and
- the percentage of amounts raised from insiders represented 48% of the total amount raised.

Disclosure and Compliance: Areas for Improvement

Stand-by Commitments

The Staff Notice highlighted the requirement for issuers entering into stand-by commitments to properly complete Item 24 of Form 45-106F15 *Rights Offering Circular for Reporting Issuers* (the “**Form**”), which requires issuers to explain the nature of their relationship with the stand-by guarantor, to disclose the security holdings of the stand-by guarantor before and after the rights offering and confirm that the stand-by guarantor has the financial ability to effectively carry out its stand-by commitment. In the Staff Notice, the CSA noted instances where disclosure regarding the issuer’s relationship with the stand-by guarantor was weak or non-existent.

Use of Available Funds

The Staff Notice noted recurring deficiencies related to issuers’ disclosure regarding working capital, liquidity and allocation of available funds. In regard to working capital disclosure, the CSA emphasized that issuers must disclose any working capital deficiency as at their most recently completed month end in the Form. The CSA also found that some issuers have not adequately explained changes to their working capital from their most recently audited annual financials to their most recent month end, as required by the Form. As noted in the Staff Notice, the CSA finds this disclosure important as it gives security holders a clearer picture of an issuer’s prospects following the rights offering than if the disclosure of the proceeds was provided without taking the working capital deficiency into account.

In regard to liquidity, the Form requires issuers whose available funds are insufficient to cover liquidity requirements for the next 12 months to discuss management’s plans to handle the shortfall, to state the minimum amount required to meet short-term liquidity demands and to discuss management’s assessment of the issuer’s ability to continue as a going concern. The CSA found that, generally, issuers’ disclosure lacked meaningful discussion regarding how such deficiency would be handled and that this disclosure is critical to investors as it highlights significant risks that the issuer is or may be facing in the short-term.

The Form also requires that issuers provide a detailed breakdown of how they plan to use available funds. The Staff Notice provided guidance on what the CSA expects regarding this breakdown and, specifically, noted that simply allocating funds to “working capital” is not sufficient to meet the requirements of the Form. In addition, the CSA expects issuers with negative cash flow from operating activities to provide a breakdown of their key expenses for at least the next 12 months.

Closing News Release

The Staff Notice reminded issuers about the requirement under the New Rules for issuers to issue a closing news release that discloses certain prescribed information about the offering, including, but not limited to:

- details concerning who subscribed to the rights offering;
- amounts subscribed for by insiders and stand-by guarantors; and
- details about how much was subscribed for through the basic privilege as compared to the additional privilege, if applicable.

The CSA also noted that there is a specific SEDAR document type under which closing news releases are required to be filed.

Table of Changes to the Prospectus-Exempt Rights Offering Regime

	Old Rules	New Rules
To whom exemption is available	<ul style="list-style-type: none"> • Reporting issuers who have filed all applicable periodic and timely disclosure documents • non-reporting issuers 	<ul style="list-style-type: none"> • Reporting issuers who have filed all applicable periodic and timely disclosure documents and who are not investment funds
Form of rights offering notice	<ul style="list-style-type: none"> • Draft Form 45-101F <i>Information Required in a Rights Offering Circular</i> ("Form 45-101F") • Distribute to security holders 	<ul style="list-style-type: none"> • Form 45-106F14 <i>Rights Offering Notice for Reporting Issuers</i> • Q&A format • Distribute to security holders • Up to 2 pages in length
Form of rights offering circular	<ul style="list-style-type: none"> • Final Form 45-101F • Distribute to security holders • Mining issuers may need to fulfill NI 43-101 <i>Standards of Disclosure for Mineral Projects</i> 	<ul style="list-style-type: none"> • The Form (as defined above) • Q&A format • Publish electronically on SEDAR • Up to 10 pages in length
Exchange review requirements	<ul style="list-style-type: none"> • Acceptance by TSX/TSXV before offering proceeds 	<ul style="list-style-type: none"> • Acceptance by TSX/TSXV before offering proceeds
Securities commission review requirements	<ul style="list-style-type: none"> • Review process typically takes 40 days 	<ul style="list-style-type: none"> • No review process
Maximum dilution	<ul style="list-style-type: none"> • 25% of securities of type offered under rights offering in any 12 month period 	<ul style="list-style-type: none"> • 100% of securities of type offered under rights offering in any 12 month period
Exercise period for rights	<ul style="list-style-type: none"> • Between 21 and 90 days* 	<ul style="list-style-type: none"> • Between 21 and 90 days



	Old Rules	New Rules
Basic Privilege	<ul style="list-style-type: none"> Must be offered to current security holders 	<ul style="list-style-type: none"> Must be offered on a pro rata basis to all security holders resident in Canada
Additional Privilege	<ul style="list-style-type: none"> If offered, must be offered to all rights holders 	<ul style="list-style-type: none"> If offered, must be offered on a pro rata basis to all rights holders
Secondary market liability	<ul style="list-style-type: none"> No 	<ul style="list-style-type: none"> Yes
Seasoning period on resale**	<ul style="list-style-type: none"> Yes 	<ul style="list-style-type: none"> Yes

*for reporting issuers only; the period for non-reporting issuers is less than 60 days

**securities will be immediately free-trading if the issuer has been a reporting issuer in good standing for at least four months

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