KEEPING CURRENT

October 15, 2015 **www.grllp.com**

REGULATORS PROVIDE EXISTING SHAREHOLDERS WITH THE MEANS TO SAVE THE JUNIOR CAPITAL MARKETS THROUGH THE USE OF THE NEW RIGHTS OFFERING AND EXISTING SHAREHOLDER EXEMPTIONS

By Bill Johnstone

The relatively new Existing Shareholder Exemption and the changes to the Rights Offering Exemption, which come into effect on December 8, 2015, have substantially improved the ability of reporting issuers to raise capital from existing shareholders. Many junior companies have valuable assets with substantial funds invested. While conventional sources of financing have disappeared, existing shareholders are the only "untapped" source of financing. The regulators have provided the means by which existing shareholders can save the junior capital markets and they must rise to the occasion.

To highlight the new exemptions, the following is a very brief synopsis:

Existing Shareholder Exemption

This is a private placement exemption that allows issuers to offer up to 100% of outstanding capital (including securities issuable on the exercise of warrants) to existing shareholders without the requirement that they be accredited investors. Provided the offering is made to all security holders in Canada, any shareholder can subscribe for up to $15,000 of securities (and more if they have advice from an investment advisor) provided they are a shareholder on the record date for the offering and continue to be one at closing. The securities can be discounted under stock exchange rules and a unit can be offered including a warrant, which again must be priced subject to the applicable stock exchange rules. The Existing Shareholder Exemption can be used along with a standard private placement to accreditor investors. An issuer can therefore respond to complaints by shareholders about dilution and the lack of fairness to existing shareholders inherent in a limited distribution private placement by offering non-accredited investor existing shareholders the ability to subscribe for securities under the offering. The use of this exemption has been very limited but so have private placements and funding of junior issuers generally since Ontario (being the last of the adopting provinces) adopted the exemption in February of 2015. Other than providing details of the offering in a press release, including the use of proceeds and the method of allocation for over-subscriptions, no disclosure document is required. The

Bill Johnstone
Partner
416-865-6505
bjohnstone@grllp.com

securities issued under the Existing Shareholder Exemption are subject to a four month hold period.

Rights Offering Exemption

This new exemption is a rights offering on steroids. All shareholders in Canada (and some other jurisdictions outside of the U.S.) can receive rights allowing them to subscribe for securities of an issuer on a pro-rata basis to maintain their percentage interest in the issuer. The disclosure requirements have been reduced and streamlined, the delays associated with review by securities commissions have been eliminated and the number of securities issuable has been increased from 25% to 100% of outstanding capital (excluding dilution associated with the exercise of warrants where the warrants have nominal or no value). The securities to be acquired on the exercise of rights must be offered at a discount to the market price when the offering commences. Presumably rights will still be tradable on stock exchanges under this exemption so existing shareholders can participate and exercise their right to maintain their pro rata interest in the issuer or sell their rights and other shareholders can increase their position by the exercise of additional rights or non-shareholders can acquire rights and become a shareholder upon the exercise of those acquired rights. The Rights Offering Exemption has a significant advantage over the Existing Shareholder Exemption in that free trading stock is received by the subscriber on the exercise of rights. The exemption requires the completion and filing of a "Notice of Rights Offering" (delivered to shareholders) and a "Rights Offering Circular" but these documents have been substantially simplified. A specific exemption has been created for a standby commitment and certain new rules apply.

While I am strongly in support of both of these changes and applaud the securities regulators for their foresight and initiative in implementing them, there remains one major roadblock to the use of these exemptions to refinance junior companies and a minor roadblock to the Existing Shareholder Exemption. The major roadblock is the lack of institutional and retail support for junior companies and the general apathy in the market. The minor roadblock is the fact that minimum pricing rules, such as the $0.05 minimum price on the TSX Venture Exchange ("**TSXV**"), make it virtually impossible for issuers trading below that minimum price to use the Existing Shareholder Exemption since it is always difficult to sell securities at a premium to the market. There exists a limited and little used TSXV provision for using the Existing Shareholder Exemption for offerings at less than $0.05. However, with respect to the use of the Rights Offering Exemption for issuers trading at less than $0.05, the minimum pricing rules may not be a factor. TSXV policies do not have any specific rules for pricing rights offerings and TSXV recognizes the need to discount a rights offering in fairness to minority shareholders. Since the Rights Offering Exemption provides for pro rata participation by all shareholders resident in Canada, it is very likely that TSXV will allow the use of the Rights Offering Exemption by an issuer trading at $0.05 or less to offer securities at a discount

to the market price based upon the fact that the securities would be available to all Canadian shareholders pro rata. This presumption makes the Rights Offering Exemption far superior to the Existing Shareholder Exemption for issuers trading below $0.05.

I was overly enthusiastic about the impact the Existing Shareholder Exemption would have on junior issuers and I am trying to contain my enthusiasm for the new Rights Offering Exemption. The major roadblock to the use of these exemptions may continue to limit capital raising by these companies.

Junior issuers, especially junior resource issuers, have been hit hard by the downturn in the capital markets. Many, if not all, of their shareholders have lost money on their investments in these companies. The bloodbath in the junior markets continues. A concept like "averaging down" has disappeared from the vernacular. This was a concept that was used by many old-school brokers to keep clients invested in junior companies. Those same old-school brokers were also involved in the support of and promotion of these issuers. Unfortunately, many of the people who had participated in the junior markets for many years have retired or passed away and those that have retired are no longer willing to risk their limited resources on "high risk-high reward" (although the jury has been out for a long time on the high reward) junior stocks. There are few, if any, market makers for junior stocks and there is an aversion on the part of financial institutions to allow their clients to, or to allow their investment advisors to recommend that their clients, invest in junior issuers. Even if this is the bottom of the market (and some are not convinced it has been hit yet), no one seems to believe that the market will move up any time soon and therefore there is no urgency to move into the market at this time. However, it is my view that there is an urgency to save these valuable assets. Junior issuers are entrepreneurial and the catalyst for the creation of value in the Canadian capital markets. While I sympathize with investors in these companies, unless something changes quickly, their investment may be lost forever, as these companies will disappear, or the lack of participation by existing shareholders may result in excessive dilution of their interest. Junior issuers are worth saving and it is incumbent upon their existing shareholders to act.

Through the Existing Shareholder Exemption and the Rights Offering Exemption, the securities commissions have taken major leaps to facilitate funding of junior issuers by existing shareholders to allow them to "average down", maintain their pro-rata interest and participate in the preservation of or the rebirth of their investments. It is time for existing shareholders to do some "soul searching" and decide if their investment in the junior markets is worth saving. If there remains value in the investment, existing shareholders must act to continue to support these companies to allow them to survive until the markets recover.

It remains to be seen if the management of junior companies will be brave enough

to ask their shareholders to invest once again by using the tools provided by the securities regulators. More importantly, it remains to be seen if those shareholders will rise to the occasion. The beauty of both exemptions is that they are offered to all security holders in Canada, but it only takes a smaller subset of existing security holders to step up and fund these companies. When that happens, those security holders that choose not to participate have no cause for complaint. The new rules are designed to treat all Canadian shareholders of a reporting issuer equally and nothing can be fairer than giving everyone an equal opportunity to invest in their own company. At the end of the day, management of a junior issuer has to act in the best interests of the corporation and preservation of the corporation and its assets is necessarily in the best interests of the corporation. It is a reasonable risk that some existing security holders may be unable or unwilling to participate in either an Existing Shareholder Exemption offering or a new Rights Offering Exemption offering, and will suffer dilution as a result, provided they are given the opportunity to participate. The end result will be the funding of and the preservation of a junior issuer and its assets by existing shareholders.

The regulators have provided the means by which existing shareholders can save the junior capital markets. Junior companies are worth saving and I implore existing shareholders to protect their interests and their investment by taking advantage of these tools and save the junior capital markets.

Bill Johnstone is a partner and Practice Leader of the Securities Law Group at Gardiner Roberts. He can be contacted at 416.865.6605 or bjohnstone@grllp.com.