

# SECURITIES LAW UPDATE

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The Securities Law Update is a periodic publication of the Securities and Corporate Law Practice Group of McLean & Kerr LLP.

In this Securities Law Update, we discuss various important aspects of the recently adopted National Policy on timely disclosure. In addition, we provide a brief update on the new Canadian Trading and Quotation System and reorganizations of The Toronto Stock Exchange and The Canadian Venture Exchange.

## ***NATIONAL POLICY ON TIMELY DISCLOSURE BY PUBLIC COMPANIES***

In an effort to address concerns about the practice of selective disclosure of information by public companies, the Canadian Securities regulators have adopted National Policy 51-201 Disclosure Standards and Rescission of National Policy 40 Timely Disclosure ("NP 51-201") and withdrawn OSC Notice 30 Confidential Material Change Reports. NP 51-201 does not in any way alter the timely disclosure obligations of companies nor does it attempt to respond to the current investor concerns regarding accounting practices. NP 51-201 does provide some useful guidance to companies and it does address certain activities affecting investor confidence. Specifically, NP 51-201:

- describes timely disclosure obligations for reporting companies and the confidential filing mechanism contained in securities legislation;
- provides interpretive guidance on existing legislative prohibitions against selective disclosure;
- highlights disclosure practices where companies take on a high degree of risk in light of the legislative prohibitions against selective disclosure;
- gives examples of the types of information likely to be material under securities legislation; and
- lists some "best disclosure" practices that can be adopted by companies to help manage their disclosure obligations.

### ***Timely Disclosure of Material Changes***

Subsection 2.1(1) of NP 51-201 provides that a reporting issuer is required to disclose a "material change" in their business.

On the timing of disclosure of a material change, NP 51-201 states that "change" initiated by a company occurs at such time as the decision is made to implement the change, which may be before a company's directors approve such change if management believes that director approval is probable.

Subsection 2.1(2) provides that any announcement of a material change should be factual, balanced and complete, including positive and negative news and containing information sufficient to permit media and investors to understand the substance and importance of the change.

In addition, Section 4.5 of NP 51-201 reminds issuers that The Toronto Stock Exchange Inc. and TSX Venture Exchange Inc. have each adopted timely disclosure policies and such policies contain obligations which exceed those found in securities legislation. Subsection 4.5(2) warns that companies which do not comply with an exchange's requirements not only could face sanction by the exchange but also could be subject to an administrative proceeding before a provincial securities regulator.

### ***Confidential Reporting of Material Changes***

Part 2 of NP 51-201 addresses the issue of confidential reporting; subsection 2.2(1) reminds issuers that if the harm to the company's business from disclosing a material change out-weighs the general benefit to the market of immediate release of the change, withholding disclosure may be justified. In addition, section 2.3 of NP 51-201 requires that where disclosure of a material change is delayed, the company must maintain complete confidentiality, and it is the company's responsibility to monitor market activity and, where such activity suggests the material change has been leaked, to publically disseminate the information.

In addition, subsection 2.3(2) stipulates that it is the company's duty to ensure persons with knowledge of such confidential material change have not made use of such information. This "duty" imposed on companies is not found in the securities legislation but may be relied upon by disgruntled investors in tort claims brought against public companies. NP 51-201 does not provide any guidance regarding how a company might discharge such duty; however following the best practices set out in NP 51-201 should be indicative that a reporting issuer has discharged this duty.

### ***Insider Trading and Tipping***

Subsection 76(1) of the *Securities Act* (Ontario) (the "Act") prohibits persons and companies in a special relationship with a reporting issuer from purchasing or selling securities of the issuer with knowledge of a material change or material fact that has not been publically disclosed, generally called "insider trading".

Subsection 76(2) of the Act prohibits reporting issuers, and person and companies in a special relationship with a reporting issuer from informing, other than in the necessary course of business, other persons or companies of a material fact or material change before such information has been generally disclosed, generally called "tipping".

Persons in a special relationship include, but are not limited to directors, officers, employees, professional advisors and anyone who learns of material information from someone known by them to be in a special relationship with the company.

The Act also creates civil causes of action where a person in a special relationship with a reporting issuer purchases or sells securities of the reporting issuer with knowledge of an undisclosed material fact or material change. Subsection 134(1) provides that such a person is liable to compensate the seller or purchaser, as the case may be, of the securities for damages as a result of such a trade unless,

- (a) the person or company in the special relationship with the reporting issuer proves that the person or company reasonably believed that the material fact or material change had been generally disclosed; or
- (b) the material fact or material change was known or ought reasonably to have been known to the seller or purchaser, as the case may be.

In addition, subsection 134(2) imposes civil liability on “tippers”. The provision provides that every reporting issuer, special relationship person and, in certain circumstances, would-be acquiror of securities or assets of the reporting issuer who informs another person or company of a material fact or material change relative to the issuer that has not been generally disclosed is liable to compensate for damages any person or company that thereafter sells securities to or purchases securities from the person or company that received the information unless,

- (a) the person or company who informed the other person or company proves that the informing person or company reasonably believed the material fact or material change had been generally disclosed;
- (b) the material fact or material change was known or ought reasonably to have been known to the seller or purchaser, as the case may be;
- (c) in the case of an action against a reporting issuer or a person in a special relationship with the reporting issuer, the information was given in the necessary course of business; or
- (d) in the case of an action against a person a would-be acquiror, the information was given in the necessary course of business to effect the take-over bid, business combination or acquisition, as the case may be.

Furthermore, subsection 134(4) stipulates that every person or company who is an insider, affiliate or associate of a reporting issuer that,

- (a) sells or purchases the securities of the reporting issuer with knowledge of a material fact or material change with respect to the reporting issuer that has not been generally disclosed;

- (b) communicates to another person, other than in the necessary course of business, knowledge of a material fact or material change with respect to the reporting issuer that has not been generally disclosed;

is accountable to the reporting issuer for any benefit or advantage received or receivable by the person or company as a result of the purchaser, sale or communication, as the case may be, unless the person or company proves that the person or company reasonably believed that the material fact or material change had been generally disclosed

Part 3 of NP 51-201 summarizes the rules set out in the Act relative to insider trading and tipping and provides some guidance on the interpretation of these rules. For example, subsection 3.2(2) emphasizes that the tipping prohibition in the Act applies to a broad range of persons, including unauthorized disclosures by non-management employees.

NP 51-201 also provides interpretive guidance on the "necessary course of business" exception, which exists to prevent the tipping prohibition from unduly interfering with a company's ordinary business activities. Subsection 3.3(2) provides that the "necessary course of business" exception would generally cover communications with:

- (a) vendors, suppliers, or strategic partners on issues such as research and development, sales and marketing, and supply contracts;
- (b) employees, officers, and board members;
- (c) lenders, legal counsel, auditors, underwriters, and financial and other professional advisors to the company;
- (d) parties to negotiations;
- (e) labour unions and industry associations;
- (f) government agencies and non-governmental regulators; and
- (g) credit rating agencies (provided that the information is disclosed for the purpose of assisting the agency to formulate a credit rating and the agency's ratings generally are or will be publicly available).

In addition, subsection 3.3(3) of NP 51-201 provides that selective disclosure in connection with a private placement or to controlling shareholders may be in the "necessary course of business". However, the Securities Commissions are of the view that the "necessary course of business" exception would not generally permit a company to make a selective disclosure of material corporate information to an analyst, institutional adviser or other market professional. Subsection 3.3(7) makes the point that disclosures to credit rating agencies, which are generally in the "necessary course of business", are fundamentally distinct from disclosures to analysts.

### ***Dissemination of Material Information***

Securities legislation prohibits a company from disclosing non-public material information to anyone, other than in the "necessary course of business", before the company *generally discloses* the information to the marketplace. Except for "material changes", which must be disclosed by news release, securities legislation does not generally require a particular method of disclosure. NP 51-201 includes guidance on how companies may satisfy the "generally disclosed" requirement.

Subsection 3.5(4) of NP 51-201 states that companies may satisfy the "generally disclosed" requirement by using one or a combination of the following disclosure methods:

- (a) News releases distributed through a widely circulated news or wire service.
- (b) Announcements made through press conferences or conference calls that interested members of the public may attend or listen to either in person, by telephone, or by other electronic transmission (including the Internet). A company needs to provide the public with appropriate notice of the conference or call by news release. The notice should include the date and time of the conference or call, a general description of what is to be discussed, and the means of accessing the conference or call. The notice should also indicate for how long the company will make a transcript or replay of the call available over its Web sit.

NP 51-201 stipulates that posting information to a company's Web Site is not sufficient to satisfy the "generally disclosed" requirement, though it also states that as technology evolves and as more people gain access to the Internet, it may be that postings to certain companies' Web Sites alone could satisfy the "generally disclosed" requirement.

### ***Best Disclosure Practices***

Part 6 of NP 51-201 sets out some practical measures companies can take to promote compliant disclosure practices. Such measures include:

1. establishing a corporate disclosure policy which is reviewed and approved by the board of directors and broadly distributed to officers and employees;
2. establishing a committee or designating a senior officer to be responsible for promoting the companies' compliant disclosure practices;
3. having the board of directors or audit committee review various disclosures in advance of their public release by the company;
4. adopting an insider trading policy that provides for a senior officer to approve and monitor the trading activity of all insiders, officers and senior employees; and

5. establishing a team responsible for creating and maintaining the company Web site, which site should include all documents filed on SEDAR and any supplemental information provided to analysts, institutional investors and other market professionals.

Reporting issuers, directors and officers should review the best disclosure practices described in detail in NP 51-201 to ensure their compliance with the various reporting requirements.

### ***CANADIAN TRADING AND QUOTATION SYSTEM***

Canadian Trading and Quotation System Inc. ("QNC") has applied to the OSC for recognition as a quotation and trade reporting system. QNC will own and operate an electronic marketplace for Ontario investment dealers to trade non-exchange listed equity securities of Ontario reporting issuers. In the July 26, 2002 *OSC Bulletin* the OSC published for comment the application of CNQ, including the Policies and Rules and draft OSC recognition order for CNQ.

### ***TSX INC. (FORMERLY THE TORONTO STOCK EXCHANGE INC.) REORGANIZING IN PREPARATION FOR ITS IPO***

Effective July 10, 2002, The Toronto Stock Exchange Inc. changed its name to TSX Inc. The Canadian Venture Exchange Inc. ("CDNX") is also planning a name change, to TSX Venture Exchange Inc., and has applied to the OSC for approval.

The reorganization of TSX Inc. will result in a newly created company, TSX Group, which will become the sole shareholder of TSX Inc. TSX Inc. will continue to own all of the shares of TSX Venture Exchange (currently CDNX). In connection with its IPO, TSX Group plans to list its shares on the Toronto Stock Exchange. In the July 26, 2002 *OSC Bulletin* the OSC published for comment details regarding the name changes and reorganization, including the application and draft order.

### ***HOW MCLEAN & KERR LLP CAN HELP***

We are available to provide you with a copy of NP 51-201 and to answer any questions you may have regarding NP 51-201, QNC or the TSE and CDNX reorganizations.

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