1.1.8 CANADIAN SECURITIES ADMINISTRATORS' NOTICE - PRE-MARKETING ACTIVITIES IN THE CONTEXT OF BOUGHT DEALS

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CANADIAN SECURITIES ADMINISTRATORS' NOTICE

Pre-Marketing Activities in the Context of Bought Deals

Background

For some time, there has been debate as to whether certain activities that may be undertaken to facilitate the distribution of securities and limit underwriting risk are contrary to, or inconsistent with, the provisions of the securities legislation of each of the provinces and territories of Canada (collectively, "securities legislation"). The debate has become more focused with the proposals made in 1992 by the Investment Dealers Association of Canada (the "IDA") to modify "bought deals".

Summary

This notice summarizes the conclusions of staff of each of the Canadian Securities Administrators (collectively "staff") on the legality of "pre-marketing" activities in the context of bought deals[1]. These conclusions are set out under the heading "Permitted and Prohibited Pre-Marketing" below.

What is Pre-Marketing?

The term "pre-marketing" has no legal meaning. In the context of a bought deal, pre-marketing is understood generally to include communications by a dealer, directly or through any of its directors, officers, employees or agents, with any person or company (other than another dealer) for the purpose of obtaining from that person or company information as to the interest that it, or any person or company that it represents, may have in purchasing securities of the type that are proposed to be distributed, prior to a preliminary prospectus relating to those securities being filed with the relevant securities regulatory authorities. In this notice, "pre-marketing" will be used to denote this range of activities.

Legislative Framework

The provisions of securities legislation that circumscribe pre-marketing activities are:

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[1] In this notice, the staff of each province and territory set out their views with respect to the securities law of their own jurisdiction only.

- those dealing with distributions of securities that circumscribe generally the manner in which information may be communicated in furtherance of a distribution of securities, and

- those dealing with continuous disclosure obligations of reporting issuers and with tipping, insider trading and self dealing, that proscribe the dissemination of previously undisclosed material information and trading on the basis of such information by persons in a special relationship with a reporting issuer.

This notice focuses on the extent to which pre-marketing may be undertaken by dealers within the rules applicable to the distribution of securities under securities legislation. The notice does not discuss the application of the tipping and insider trading provisions of securities legislation as these provisions are very much fact specific, involving the question of whether an undisclosed material fact or material change has been used or communicated other than in the necessary course of business. As the current legal regime, insofar as it relates to tipping and insider trading, will continue to apply, compliance with this notice will not affect a legal determination that tipping or insider trading has occurred nor will it affect any action that securities regulatory authorities would take in respect of such activities.

Pre-Marketing under the Rules Governing the Distribution of Securities

Securities legislation provides generally that no one may trade in a security where that trade would be a distribution unless a preliminary prospectus and (final) prospectus have been filed and the necessary receipts obtained from the relevant securities regulatory authority. This requirement does not extend to distributions that are specifically exempt from these requirements under securities legislation.

The analysis of whether particular pre-marketing activities may or may not be carried out under this regime turns largely on whether such pre-marketing activities constitute a trade and, if so, whether such a trade would constitute a distribution that is not exempt from the prospectus requirements of securities legislation (a "non-exempt distribution").

In the Province of Quebec, since securities legislation has been designed without the notion of a "trade", the analysis is dependent solely on whether the pre-marketing activities constitute a distribution.

Does Pre-Marketing Constitute a "Trade"?

Securities legislation (other than the securities legislation of Quebec) defines a "trade" in a non-exhaustive manner to include, among other things:

- any sale or disposition of a security for valuable consideration,

- any receipt by a registrant of an order to buy or sell a security, and

- any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of any of the foregoing.

Pre-marketing activities are, at a minimum, "conduct directly or indirectly in furtherance" of the sale of a security and therefore fall within the definition of a trade.

Does Pre-Marketing Constitute a Non-Exempt Distribution?

Even though pre-marketing activities constitute a "trade" for the purposes of securities legislation (other than the securities legislation of Quebec), they would be prohibited only if they also constituted a distribution under securities legislation. Securities legislation (other than the securities legislation of Quebec) defines a distribution to include a "trade" in, among other things, previously unissued securities and securities that form part of a control block.

The definition of distribution under the securities legislation of Quebec includes the endeavour to obtain or the obtaining, by an agent, of subscribers or purchasers of securities being distributed.

The definitions of trade, and in the Province of Quebec the definition of distribution, are so broad as to include potentially every activity, however remote from the actual sale of a security, within the securities legislation prohibition on trading or distributing securities absent a preliminary prospectus or (final) prospectus having been filed. Staff, however, believe that such an interpretation is incorrect. For communications to form part of a distribution, it is staff's view that they must be undertaken within the context of the distribution.

The view that pre-marketing undertaken in the period between the execution of an underwriting agreement and the filing of a preliminary short form prospectus forms part of the distribution is implicit in blanket rulings or orders issued by the Alberta, British Columbia, Ontario, Manitoba, Quebec and Saskatchewan securities commissions. The blanket rulings should not, however, be interpreted as implying that pre-marketing undertaken in advance of the execution of an underwriting agreement is not part of a distribution. Staff believe that such an interpretation is too restrictive.

Permitted and Prohibited Pre-Marketing

It is the view of staff that a distribution commences at the time (the "Commencement of Distribution") when:

- a dealer has had discussions with an issuer or a selling security holder, or with another dealer that has had discussions with an issuer or a selling security holder about a distribution of securities ("Distribution Discussions"), and

- those Distribution Discussions are of sufficient specificity that it is reasonable to expect that the dealer (alone or together with other dealers) will propose an underwriting of the securities to the issuer or the selling securityholder, as the case may be.

Staff understand that many dealers communicate on a regular basis with clients and prospective clients concerning their interest in various securities. Staff do not believe that such ordinary course communications generally are made in furtherance of a distribution. However, from the Commencement of Distribution, communications by the dealer, with a person or company designed to have the effect of determining the interest that it, or any person or company that it represents, may have in purchasing securities of the type that are the subject of the Distribution Discussions, that are undertaken by any director, officer, employee or agent of the dealer:

(i) who participated in or had actual knowledge of the Distribution Discussions, or

(ii) whose communications were directed, suggested or induced by a person referred to in (i) or another person acting directly or indirectly at or upon the direction, suggestion or inducement of a person referred to in (ii),

are, in staff's view, in furtherance of the distribution and contrary to securities legislation. Therefore, from the Commencement of Distribution until the earliest of:

- the issuance of a receipt for a preliminary prospectus in respect of the distribution,

- the time at which a press release that announces the entering into of an enforceable agreement in respect of a bought deal is issued and filed in accordance with any blanket ruling or order, or notice made pursuant to an existing blanket ruling or order, of a securities regulatory authority of a province or territory of Canada, and provided that all of the conditions set forth in such blanket ruling or order or such notice and its related blanket ruling or order are met, and

- the time at which the dealer determines not to pursue the distribution,

no such communications are permitted.

Market making and other principal trading activities in securities of the type that are the subject of the Distribution Discussions would be similarly prohibited if engaged in from the Commencement of Distribution until the earliest of the points in times indicated above, by a person referred to in (i), above, or at or upon the direction, suggestion or inducement of a person or persons referred to in (i) or (ii), above.

Are Prospectus Exemptions Available?

It has been suggested by some that, even if clearly made in furtherance of a distribution, pre-marketing could be undertaken in certain circumstances. Specifically, it has been suggested that if an exemption from the prospectus requirements would be available in respect of a specific distribution, pre-marketing of such distribution is exempt from the prospectus requirements.

This analysis is premised on an argument that the pre-marketing constitutes one distribution that is exempt from the prospectus requirements while the actual sale of the security to the purchaser constitutes a second discrete distribution effected pursuant to the prospectus. Staff are of the view that this analysis is contrary to securities legislation. It is staff's view that, in these circumstances, the distribution in respect of which the pre-marketing activity is undertaken is the distribution pursuant to the anticipated prospectus. The pre-marketing activity must be viewed in the context of the prospectus offering and as an activity in furtherance of that distribution. If it were otherwise, the overriding concerns implicit and explicit in securities legislation regarding equal access to information, conditioning of the market, tipping and insider trading, and the provisions of the legislation designed to ensure such access to information and curb such abuses, could be easily circumvented.

Staff recognize that an issuer and a dealer may have a demonstrable bona fide intention to effect an exempt distribution and this distribution may be abandoned in favour of a prospectus offering. In these limited circumstances, in the view of staff, there are two separate distributions.

From the time when it is reasonable for a dealer to expect that a bona fide exempt distribution will be abandoned in favour of a prospectus offering, the rules relating to pre-marketing outlined above apply.

Compliance

Staff are of the view that dealers should develop, implement, maintain and enforce procedures to ensure that pre-marketing activities that are contrary to securities legislation are not engaged in by their directors, officers, employees and agents. The selection and implementation of appropriate procedures is the responsibility of each dealer.