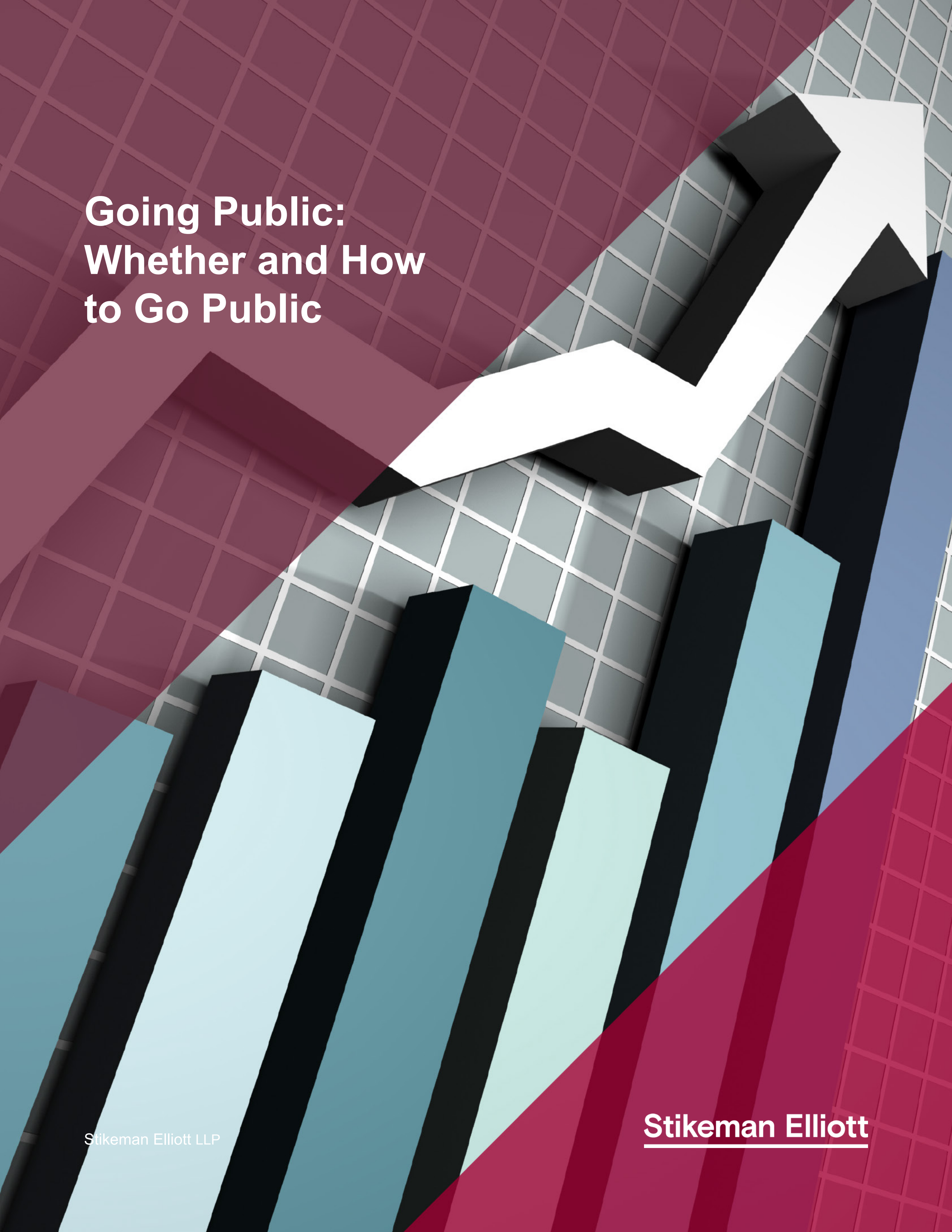

Going Public: Whether and How to Go Public

Stikeman Elliott LLP

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Advantages and Disadvantages of Being a Public Company

Potential advantages resulting from going public include:

- immediate equity capital (the immediate equity infusion can be used for expansion or to reduce indebtedness), likely at more attractive multiples than private equity financing, thus reducing dilution to existing shareholders and avoiding the interest costs of debt financing;
- liquidity for existing shareholders (subject to any escrow requirements imposed by the TSX or the OSC, which are discussed below, agreements with underwriters and statutory restrictions on resale), which may assist them with estate planning and portfolio diversification;
- improved opportunities for future financing (an IPO usually provides increased access to a broader range of financial markets and vehicles, including additional common equity, convertible debt, convertible preferred shares and rights offerings to existing shareholders and others, as well as making debt and preferred share markets easier to tap by increasing the company's exposure, improving debt/equity ratios and making it easier to attract financing on more attractive terms);
- increased ability to complete mergers and acquisitions both by using the issuer's publicly traded shares as "acquisition currency" and by raising cash through the sale of additional equity, thus increasing flexibility;
- increased ability to attract and retain personnel and improved opportunities for management and employee compensation (e.g. through stock options or similar compensation arrangements and/or stock purchase plans);
- increased prestige and a higher profile generally, with resulting potential for improving corporate image and relationships with the community, customers and suppliers;
- the facilitation of valuations, better enabling creditors, suppliers and others to place more accurate values on the company; and
- the ability to conserve cash and declare stock dividends.

In determining whether a public offering is appropriate, a number of other factors should also be considered, including:

- the potential loss of control for the founder(s) of the company;
- sharing of success with new shareholders;
- the loss of confidentiality due to initial prospectus and periodic financial reporting and other ongoing public disclosure requirements (with the obligation to disclose both good and bad news, including disclosure of material contracts that are entered into outside the ordinary course of business);
- the commitment of time and resources and incurring of expenses in the IPO process and subsequently to address such matters as board meetings (including audit and other committees and independent directors), shareholders' meetings,

compliance with the requirements of securities laws and stock exchange rules, discussions with analysts and reporters, more detailed and complex financial information requirements, accounting and auditing matters, disclosure and internal control systems and procedures, as well as certifications;

- the potential loss of certain tax benefits that may have been available to both the company and its shareholders;
- the potential loss of flexibility as a result of regulatory requirements, including in respect of related party or conflict of interest transactions;
- the accountability, duties and potential liabilities to public shareholders, which may require conducting the business in a more formal manner and imposing greater short-term performance pressures; and
- a higher profile generally could lead to unwanted publicity and damage the corporate image and relationships with the community, customers and suppliers, including in such areas as regulatory relationships, the environment, lawsuits and similar disputes and contingent liabilities.

Initial Public Offering (IPO)

An initial public offering is one of a number of ways to obtain a listing on the TSX. This is usually completed by way of formal prospectus filed with the OSC and/or other Securities Commissions. Alternatives to IPOs are discussed later in this chapter.

Treasury Versus Secondary Offering

If you have not already done so, you will undoubtedly be engaging in discussions regarding the possibility of an IPO with investment dealers in order to obtain an assessment of the likely market reception for an IPO and advice as to the structure of the offering. It is possible to do a treasury (or "primary") issue, in which new shares are issued for cash to the public, or a "secondary" issue, in which a portion of the shares held by existing shareholders are offered for sale and the proceeds accrue to such shareholders either immediately or on an installment basis. On occasion, an IPO ends up being a mixed primary and secondary offering to address both company financing and shareholder liquidity needs. As new investors often prefer to fund an issuer rather than provide liquidity to controlling shareholders, secondary participation is usually limited to some extent. As discussed in more detail later in this section, escrow requirements may also impact the participation of shareholders in respect of a secondary offering.

Where a secondary offering is being made pursuant to the same prospectus as a primary distribution, the selling shareholders often bear a proportionate share of the expenses of the offering, although this is not a legal requirement. In any event, under the prospectus form requirements, appropriate disclosure must be made of the share of the expenses borne by the selling shareholders, and if none of the expenses of the distribution are being borne by the selling securityholders, this must be disclosed in a statement along with the rationale.

IPOs have traditionally involved common shares. Not infrequently, units consisting of a common share and a warrant representing a right to buy additional shares at a predetermined price are offered to the public in a treasury offering, thus providing the possibility of future additional financing as well as additional “upside participation” to initial investors.

Escrow Issues for Initial Public Offerings

National Policy 46-201 *Escrow for Initial Public Offerings* imposes uniform terms of escrow under which, if applicable, management and key insiders of a newly listed public company must retain an equity interest for a period of time following the IPO. The policy rationale underlying these types of escrow requirements has historically been to bolster investor confidence by aligning the interests of management, key insiders and securityholders with the issuer by requiring them to hold on to their interests for a specified period.

Who must escrow shares?

The escrow rules, which restrict “principals” of a non-exempt issuer (discussed in detailed below under “Escrow Release Timetable”) from selling their interest for a specified period, apply to IPOs and secondary offerings that are essentially IPOs (e.g. corporate spin-offs). “Principals” include individuals falling into one of these categories on the completion of the IPO:

- Directors and senior officers of the issuer or a material operating subsidiary of the issuer;
- Promoters of the issuer during the two years preceding the IPO;
- Persons who own and/or control more than 20% of the issuer’s voting securities immediately before and immediately after completion of the IPO; and
- Persons who own and/or control more than 10% of the issuer’s voting securities immediately before and immediately after completion of the IPO, and have elected or appointed, or have the right to appoint a director or senior officer of the issuer or of a material operating subsidiary of the issuer.

A company, trust, partnership or other entity more than 50% held by one or more principals will be treated as a principal. A principal’s spouse and relatives that live at the same address as the principal will also be treated as principals and any securities of the of the issuer they hold will be subject to escrow requirements.

A principal that holds less than 1% of the votes immediately after the IPO is not subject to the escrow requirements.

Escrow release timetable

The length of the escrow period (if any) depends on the category the issuer is in upon completion of the IPO. Under NP 46-201, an issuer is placed into one of three categories:

- Exempt Issuers – (A) Issuers listed on the TSX in its exempt category (non-junior issuers), or (B) issuers that have a market capitalization of at least $100 million;
- Established Issuers – Issuers that, after an IPO, have securities listed on the TSX and are not classified as an exempt issuer or have securities listed on the TSX Venture and are TSX Venture Tier 1 issuers; or Emerging Issuers – Issuers that, after the IPO, are not exempt issuers or established issuers.

No escrow is imposed in the case of exempt issuers. For established and emerging issuers, escrowed securities are generally released as set out in the following table.

	Established Issuers		Emerging Issuers	
	% Released	Cumulative % Released	% Released	Cumulative % Released
Date of the IPO	25% exempt from escrow	25%	10% exempt from escrow	10%
6 months	25% released	50%	15% released	25%
12 months	25% released	75%	15% released	40%
18 months	25% released	100%	15% released	55%
24 months	–	–	15% released	70%
30 months	–	–	15% released	85%
36 months	–	–	15% released	100%

Secondary offerings under the prospectus

A principal is permitted to sell all or any portion of its securities of the issuer to the public in the issuer's IPO free of escrow provided that the secondary distribution is disclosed in the issuer's IPO prospectus, and the issuer's IPO is firmly underwritten. Further, a principal (other than a director, senior officer or promoter) may sell securities as a best efforts secondary offering in the IPO free of escrow, subject again to disclosure in the issuer's IPO prospectus, and provided that all securities offered in the IPO by the issuer are sold before any sale is completed under the secondary offering.

Transfers in escrow

Transfers of securities subject to escrow are generally not permitted, other than transfers to:

- existing or incoming directors or senior officers of the issuer or of a material operating subsidiary, subject to board approval;
- a person or company that was already a 20% voting holder before the transfer;
- a person or company that becomes a 10% voting holder after the transfer and has the right to elect or appoint one or more directors or senior officers of the issuer or any of its material operating subsidiaries;
- an RRSP or similar tax deferred plan (of the transferee);
- a trustee in bankruptcy; and
- a financial institution upon realization of escrow securities pledged, mortgaged or charged as collateral for a loan (although the escrowed securities must remain escrowed in the hands of the financial institution for the remainder of the applicable escrow period).

In addition, the TSX may also impose escrow requirements on issuers not otherwise subject to NP 46-201 that have listed on the TSX through reverse takeovers or by completing a qualifying acquisition with a special purpose acquisition corporation (SPAC). The TSX may also impose escrow requirements on principals of a spin-off entity listing on the TSX where those principals acquired their securities under a net asset value private placement (or where the market price was unknown). The TSX has indicated that if such placements are not accompanied by a satisfactory contractual escrow, TSX may use its discretion to impose escrow terms to facilitate the retention of insiders and other service providers.

Other resale restrictions

In addition to regulatory escrow requirements, companies contemplating an IPO should be aware that underwriters in an IPO generally place time-based (e.g. 180 – 365 days) contractual limitations on the ability of certain insiders to sell their securities of the issuer without underwriter consent. Companies may also be restricted by underwriters in further issuances for a limited period of time. Issuers should also note that under National Instrument 45-102 *Resale of Securities*, pre-IPO stock may not be freely tradable until the expiry of any applicable seasoning period (which is generally four months from the date of distribution or the date the issuer becomes a reporting issuer, but is accelerated upon going public by filing a prospectus). Sales by a so-called “control block” holder of securities (generally, holdings by a person of more than 20% of the outstanding voting securities) also trigger prospectus requirements unless made pursuant to a prospectus exemption, including an exemption that allows control block holders to sell securities provided that the prescribed notices are filed. Appropriate pre-IPO structuring may be completed to avoid the limitations on resale in certain cases.

Alternatives to IPO

Reverse Take-overs (Backdoor Listings)

Alternatively, it is possible to obtain a listing by means other than an IPO. While not technically an original listing, certain transactions (generally referred to as "backdoor" listings or "reverse take-overs") are treated in effect as if they were an original listing by the TSX. Under TSX rules, a backdoor listing occurs when an issuance of securities of a listed company results, directly or indirectly, in the shareholders of a listed company owning less than 50% of the shares or voting power of the resulting company, with an accompanying change of effective control of the listed company. The transaction giving rise to a backdoor listing may take one of a number of forms, including an issuance of shares for assets or an amalgamation or a merger. A backdoor listing by itself does not raise any new funds from public investors, but rather represents a method of, in effect, buying the existing public company's listing and public distribution. Additional financing is often raised by completing a contemporaneous private placement or, on occasion, a subsequent public offering. Of note, the TSX is considering amendments to the TSX rules intended to better define backdoor listings and clarify the discretion of the TSX to exempt a transaction from the requirement to meet original listing requirements or consider a transaction a backdoor listing even where it would not otherwise qualify as such.

These types of transactions must be effected in accordance with stock exchange rules, which include the satisfaction of original listing requirements, an exchange review process and obtaining of shareholder approval. Special approval levels or voting requirements may be imposed by the TSX, and valuations or independent assessments may be required, particularly in the case of a non-arm's length transaction. The TSX may also require that the securities issued pursuant to a backdoor listing be fully or partially escrowed in accordance with the TSX's Escrow Policy. In deciding whether an escrow is appropriate in such circumstances, the TSX will generally seek to apply the same principles set out in National Policy 46-201 *Escrow for Initial Public Offerings,* discussed in detail above.

Capital Pool Company (CPC)

Similar to the SPAC program for the TSX described below, the Capital Pool Company Program provides an option for issuers wanting to list on the TSX-V.

A CPC is a shell company that is formed by a group of experienced public company managers who capitalize the CPC with an initial injection of seed financing. Once formed, the CPC raises a modest amount (e.g. $200,000) of additional capital through a prospectus IPO and is temporarily listed for trading on the TSX-V as a CPC. Once the CPC is capitalized and trading has commenced, the CPC has 24 months to complete a qualifying transaction, generally by acquiring a business that meets certain listing requirements of the TSX-V. Once the qualifying transaction has closed, the CPC becomes an operational public company traded on the TSX-V and its CPC designation is removed. The private company or business acquired benefits from the experience of the CPC management team and the capital situate in the CPC. Simultaneously, the CPC and its management benefit by acquiring a ready-made and growing business and bringing it to the capital markets.

Special Purpose Acquisition Corporation (SPAC)

Similar to CPCs, SPACs are investment vehicles that allow the public to invest in businesses or assets usually sought by private equity firms. A SPAC is initially a shell company with no previous operational history that goes public through an IPO raising at least $30 million, with the intention of using the proceeds to acquire a business by acquiring either shares or assets. Once the SPAC's IPO distribution has closed and its securities are listed, the SPAC has 36 months to complete a qualifying acquisition. At least 90% of the proceeds raised from the IPO (and the deferred underwriting commissions) must be placed in escrow to be applied towards the funding of the qualifying acquisition. The qualifying acquisition is not restricted geographically or on any target sector, other than as may be disclosed in the SPAC's IPO prospectus. If the qualifying acquisition is not completed within the prescribed time period, the escrowed funds raised on the IPO will be distributed *pro rata* to securityholders and the SPAC de-listed. Following its IPO, the SPAC must prepare and file another prospectus containing disclosure regarding the SPAC assuming completion of the proposed qualifying acquisition. Once this final prospectus is receipted by applicable securities regulators, the SPAC must obtain the approval of its securityholders to proceed with the qualifying acquisition by a majority of votes cast by non-founding securityholders and a majority of directors unrelated to the acquisition. Once the qualifying acquisition has closed, the issuer resulting from the qualifying acquisition must meet the TSX's original listing requirements.

Considerations for International Companies

Going public in Canada is, in a broad sense, not dissimilar to going public in the United States. There are, however, some important differences. For one thing, the U.S. has a much more developed over-the-counter market, and some Canadian companies bypass stock exchanges in favour of these systems, which tend to be somewhat less regulated.

In addition to the more rigorous Sarbanes-Oxley disclosure requirements, the U.S. environment has historically also been much more litigious, with the result that a company may be opening itself up to greater securities litigation risk in the United States. Further, the costs involved in a U.S. public offering may well exceed the equivalent Canadian costs due to higher legal, audit, printing, D&O liability insurance and other costs.

Due to its size and diversity, the U.S. market may be able to complete transactions that could not be completed in Canada alone. On the other hand, companies that may be small or mid-cap by U.S. standards will often be mid-cap to large-cap by Canadian standards, thereby attracting greater profile and enhanced analyst coverage, trading and liquidity.

The Multijurisdictional Disclosure System (MJDS) provides a mechanism for established Canadian companies meeting specified size requirements and with specified reporting histories to access the U.S. market on a streamlined basis. In a similar vein, Canadian companies doing offerings in Canada that complete a parallel private placement to sophisticated investors in the U.S. can tap into U.S. investor demand without becoming subject to either initial or extensive ongoing compliance requirements under U.S. securities laws. Accordingly, a Canadian company looking at eventually establishing a U.S. shareholder base may be able to accomplish this objective without going to the expense of completing an IPO in the United States.

About the Firm

When Heward Stikeman and Fraser Elliott first opened the firm's doors in 1952, they were united in their pledge to do things differently to help clients meet their business objectives.

In fact, they made it their mission to deliver only the highest quality counsel as well as the most efficient and innovative services in order to steadily advance client goals.

Stikeman Elliott's leadership, prominence and recognition have continued to grow both in Canada and around the globe. However, we have remained true to our core values.

These values are what guide us every day and they include:

- Partnering with clients – mutual goals ensure mutual success.
- Finding original solutions where others can't – but they must also be grounded in business realities.
- Providing clients with a deep bench of legal expertise – for clear, proactive counsel.
- Remaining passionate about what we do – we relish the process and the performance that results from teamwork.

A commitment to the pursuit of excellence – today, tomorrow and in the decades to come – is what distinguishes Stikeman Elliott when it comes to forging a workable path through complex issues. Our duty and dedication never waver.

This is what makes Stikeman Elliott the firm the world comes to when it counts the most.

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