



Completing a Substantial Private Placement with a TSXV-listed Oil & Gas Company

June 25, 2015

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In the wake of major declines in oil and gas prices and reduced access to capital in the public markets, a number of TSXV-listed companies are considering substantial private placements to raise capital.

Typically a substantial private placement involves the direct or indirect acquisition of 20% or more of the equity by either the purchase of common shares or convertible securities

These transactions create interesting opportunities for investors to obtain discounted equity pricing, governance controls and/or convertible securities, all in an effort to establish a suitable economic reward for the risk of holding a minority position in a public company and ensuring that management is focused on improving outcomes.

The substantial private placement is an appealing alternative to M&A for many management teams and incumbent shareholders in a down market, where leadership can't quickly find new funding after a takeover and where the equity has strong incentives to avoid giving up.

At the same time, it offers investors the ability to earn a return on the target's improved performance without paying a premium to market for the equity or committing as much capital.

Investors considering a substantial purchase of common shares or securities convertible into common shares from a TSXV-listed oil and gas company should consider the following key commercial and regulatory issues.

Structure and Process

The substantial private placement is typically completed by way of the following steps:

- initial discussion and review of economic parameters
- execution of letter of intent regarding key terms and providing for exclusivity of negotiations by the target
- completion of the commercial and legal diligence
- negotiation of investment agreement and receipt of TSXV approval
- execution of investment agreements and press release regarding the transaction
- closing of initial investment
- completion of shareholder approval for the remaining investment

- completion of remaining investment

If a shareholder meeting is required, the process typically takes approximately 10 to 12 weeks to complete, from execution of the letter of intent, and may be reduced to as little as 8 weeks if the investor and target are motivated and organized.

The key elements of a substantial investment letter of intent include the following:

- pricing and magnitude of initial share or convertible security assurance
- terms of interest and interest payments for any convertible debt
- terms of warrants, if applicable
- information rights of the investor
- board appointment and nomination rights of the investor
- registration rights of the investor
- positive controls over the business
- negative controls over the business
- pre-emptive rights governing participation in the future security issuances
- ratchet compensating for down-round issuances
- right to invest additional capital
- adoption (or future review) of business plan
- use of proceeds requirements
- standstill governing further takeover activity by the investor
- subordination arrangements with senior credit (where a convertible debt instrument is used)
- exclusivity during period of negotiation of investment agreement
- voting agreements to support approval of the transaction

We would be pleased to provide a copy of our model letter of intent for a substantial private placement. Please email rsvp@stikeman.com with your request.

Shareholder Approval

A TSXV company that wishes to use a private placement that will result in a shareholder holding 20% of the outstanding common shares (either immediately or upon the exercise of conversion rights) must either obtain approval from a majority of shares voted by existing shareholders at a shareholder meeting or by written consent from shareholders holding a majority of the shares.

At the discretion of the TSXV, this obligation may also be triggered if the investor owns less than 20% of the shares but has sufficient board representation and negative or positive controls on the business. This issue must be discussed as part of the regulatory review of the transaction before announcement and ideally at the letter of intent stage.

Pricing

The TSXV requires that common shares issued in a private placement be issued at a price that is equal to or greater than the closing price of the shares on either the day before:

- the day the company announces a transaction; or
- the day the target files a price reservation form,

less a discount of up to 25% (where the price is \$0.50 or less, subject to a minimum price per share of \$0.05), 20% (where the price is between \$0.51 and \$2.00) or 15% (where the price is \$2.00 or more).

The target selects which price it will use as a reference.

A price reservation form may be filed by the target at any time and lasts for 30 days. Price reservation forms may be renewed. The form does not need to state a proposed use of proceeds. The TSXV reserves the discretion to deny use of a reserve price depending on market activity after the form is filed. Insiders subscribing for more than 25% of the private placement cannot participate at the reserved price if a price reservation form is used – instead if those insiders want to be able to rely on any price reservation, the price reservation must be made through a comprehensive news release

Convertible notes, preferred shares or other convertible instruments must have a conversion price equal to the market price described above (no discount is allowed). Convertible securities can't have a term of more than five years. They may be transferred without the need for TSXV consent, but may be subject to securities law transfer restrictions for securities sold on a private placement basis.

Warrants must be priced in the same way as convertibles and cannot have a term of more than five years. The number of shares issuable on the exercise of the warrants cannot exceed the total number of common shares issued (or issuable on exercise of the convertibles). Warrants on warrants are not permitted. Warrants may also be transferred without the need for TSXV consent, but may be subject to securities law transfer restrictions for securities sold on a private placement basis.

These rules become more restrictive if the investor agrees to provide (and prices) the funding at a time when the target is negotiating or has completed an acquisition or other material transaction which has not been disclosed (an Undisclosed Transaction).

In that case:

- the substantial placement must be integral to the Undisclosed Transaction;
- the market price (for the purpose of pricing the deal) is the closing price the day before announcement of the Undisclosed Transaction (a price reservation form cannot be used);
- the proceeds from the substantial placement must be specifically allocated and necessary for the Undisclosed Transaction (and the announcement needs to make this clear – a statement that proceeds are for general working capital purposes will not suffice); and
- any warrants issued as part of the placement must be exercisable at a premium to the market price - 50% (where the price is \$0.50 or less), 25% (where the price is between \$0.51 and \$2.00) or 15% (where the price is \$2.00 or more).

Reputation Checks

Any investor that acquires more than 10% of the shares through a substantial private placement must clear a personal information form (a PIF), or if applicable a declaration, with the TSXV before closing. In the case of funds, the fund's principal officers must clear PIFs, or if applicable, declarations, along with any of its nominees that will sit on the target's board. The TSXV background check process is similar to those used by other major exchanges. It may take four to six weeks to complete.

Escrow

When a transaction involves stock going to insiders for consideration other than cash, the TSXV will generally prevent trading in some portion of that stock for 24 to 36 months. These requirements should not apply to an arms-length cash transaction, but this should be confirmed as part of the negotiation for approval of the placement with the TSXV.

Hold Period

All of the securities acquired on a substantial private placement are subject to a four-month hold period before they can be sold, unless the investor relies on a private placement exemption to effect the subsequent sale. The hold period for shares acquired on the conversion of convertibles begins at the time of the initial placement, not at the time of conversion.

Insider Reporting

An investor that acquires more than 10% of the common shares must report that purchase, through SEDI, and all subsequent purchases and sales as long as the investor holds more than 10% of the shares.

An investor that acquires 10% or more of the common shares must promptly file a news release and within two business days from the date of the acquisition, file an early warning report through SEDAR, where the press release and early warning report must contain among other things, the percentage of shares acquired, the purpose of the acquisition and any further intention to acquire additional shares.). Generally, the investor cannot complete additional purchases during the period from the event creating the obligation to make the report until one business day after the date the report is filed.

On the acquisition of each additional 2% of the common shares, the investor must repeat the procedure in the above paragraph. Certain exemptions from this requirement are available to institutional investors, but these do not typically apply in the case of a substantial private placement. The Canadian Securities Administrators expect to release additional transparency enhancements to the “early warning” regime in Q2, 2015, which would include additional filing obligations if the investor’s share ownership fell below the 10% threshold, or if there was a 2% decline in share ownership when above the 10% threshold. For further updates on these potential changes, please visit our [securities blog](#).

For purposes of the early warning reporting requirements, common shares to be issued on conversion of other securities are included in the investor’s ownership if they are convertible within 60 days. At the same time, all shares issuable on the conversion of convertibles within 60 days are included in the denominator for purposes of completing this calculation.

Being a Control Person

An investor that completes a substantial private placement is subject to future restrictions on purchases and sales of common shares. A shareholder that owns more than 20% of shares (a Control Person) cannot buy more shares in the market unless it makes a take-over bid open to all shareholders at the same price unless the Control Person is able to rely on one of the following commonly-used exemptions:

- purchasing no more than 5% of the outstanding shares per year;
- purchasing an unlimited number of shares from a maximum of five other shareholders at a 15% or less premium to the market price.

A Control Person also faces restrictions on its ability to sell shares. A Control Person can sell into the market (provided it does not attempt to seed the market for those sales or pay unusual commissions). However, these markets are typically very illiquid and it is difficult to move a large volume of shares without substantially depressing pricing.

Alternatively, a Control Person may sell a larger block of shares by way of a prospectus prepared by the company or by completing a private placement (which is typically only open to accredited investors and requires that those investors cannot sell the shares except by further exemption for four months).

An investor that holds enough shares to “affect materially” control of the company will also be deemed to be a Control Person – whether or not the investor holds more than 20% of the shares. This is especially true if the investor has board appointment rights or other positive or negative controls over the conduct of the business.

Getting the Deal Done

A substantial private placement must be approved by TSXV before it can be closed. As a practical matter, it is normal for an investor and a target to negotiate the critical terms of the placement at the same time as they discuss the transaction with the TSXV. This provides opportunity to confirm that all of the key

commercial terms will be acceptable to the exchange, including pricing, the nature of shareholder approval requirements and other issues. The TSXV has substantial discretion over the approval of the placement. This process should occur before a press release is made regarding the transaction.

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