Abstract

The Lifecycle of a Cross-Border Bond: So you want to do a deal in Canada, Eh?

This program explores the life cycle of U.S./Canada cross-border bonds. In particular, the program will explore eligibility of the indenture trustee, Canadian regulatory issues, and default and insolvency. Further, we discuss some recent developments in Canada, including the legalization of cannabis in Canada and how that industry is financed.

These issues are significant given the huge volume of such cross-border transactions. Cross-border transactions between the US and Canada increased 30% from 2017 to 2018 with southbound deals into the US increasing 40% from US$80.56 billion to US$112.0 billion, while northbound deals into Canada decreased 9.8% from US$21.52 billion to US$19.42.

Regulatory Issues. Canada has 13 provincial or territorial securities commissions and no federal regulator, which is a unique regulatory structure. And, even though the regulators have enacted a number of national, multilateral, and local rules and policies that seek to harmonize the rules across the country and the regulators often cooperate, the system has been less than ideal. In 2018, several provinces and the federal government sought to create a Cooperative Capital Markets Regulatory System and signed a Memorandum of Understanding, which the Supreme Court held was constitutional.

Cannabis. In 2018, Canada became the second country to legalize cannabis for recreational use. Canada saw an increase of cannabis related issuers coming to market in the last half of 2016 through 2018. Meanwhile, there is uncertainty in the U.S. due to the conflict of laws among the 31 states plus the District of Columbia that have legalized cannabis for either medicinal or recreational use, while cannabis remains illegal at the federal level. As a result, producers with US assets or operations have found it harder to raise funds. In fact, the [Toronto Stock Exchange] announced it would not list any new cannabis companies with US assets or operations and could potentially delist companies with US operations which lead to companies having to divest US operations. The smaller Canadian Securities Exchange does not share the TSX’s position on issuers with US operations and currently lists 124 cannabis related issuers. Given how emerging this sector is there is potential for Canada to gain first mover advantage in this space.

Enforcement, Default and Insolvency. Bondholders are increasingly taking an active role in restructuring proceedings in Canada and the US. In most situations, bondholders are sophisticated, engaged and active in the proceedings. As a result, they play a pivotal role in many restructurings. They often hold a blocking vote in any plan for reorganization, and therefore are often consulted, and provide input, as the restructuring proceeds. The restructuring processes in Canada and the US have many similarities, but also many differences. Having counsel acting for the bondholders who understand the cross-border insolvency process, and
conversely, insolvency counsel for the other stake holders who understand the role of the bondholders, is important and key to a successful restructuring.

The program will also explore: (i) what constitutes an event of default?; (ii) when does a default permit bondholders to act, how holders can make demand and get authority to act?; (iii) engaging representative groups, taking instructions from a large group, dealing with conflicts and differences of opinion within the group; (iv) the role of the indenture trustee: if the indenture trustee should have independent counsel, what steps the trustee can take in various restructuring proceedings and when it will be stayed, how it can have a voice in negotiation, determining goals and level of activism, pre and post-filing considerations and maximizing value?; and (v) emergence from restructuring proceedings, including what a restructured bond deal may look like.

Some Illustrative Canadian cases. *Orphan Well Association, et al. v. Grant Thornton Limited, et al* 2019 SCC 5 (*Redwater*) involved a bankruptcy in Alberta’s oil patch. Prior to the decision, indenture trustees were entitled to sell all economic oils and disclaim uneconomic wells without paying or accounting for the clean-up cost. It was ruled that while trustees will not be personally liable for abandonment and reclamation obligations, the estate will remain liable for such obligations; reclamation and abandonment liabilities must be dealt with before there can be any distribution to the insolvent party’s creditors (including its secured creditors). So, reclamation will now become part of the cost of doing business, which may make it harder for oil patch producers to get lending etc.

*Katanga Mining Ltd. (OSC, 2018)* involved misleading continuous disclosure regarding mine production and financial performance plus internal controls failures and weak corporate governance. It was held that “[d]irectors and officers set the ‘tone from the top’ and are responsible for establishing and enforcing a culture of compliance.” Individual sanctions ranged from $350,000 to $2.45 million and bans on acting as officers/directors for 2 to 6 years.
American Bar Association

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Recent Stats
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- Cross-border transactions between US and Canada saw a 30% increase from 2017 to 2018
- Southbound deals in to the US increased 40% from US $80.56 billion in 2017 to US $112.0 billion in 2018
- Northbound deals in to Canada decreased 9.8% from US $21.52 billion in 2017 to US $19.42 in 2018
Role of Bondholders
Role of the Bondholders in Canada/US

- In both jurisdictions, usually sophisticated, active, large
- Represented as a group by one or two law firms
- Often have blocking vote
- Always have important role
In the Process

- Bondholders occasionally surprised at the differences between Canadian/US proceedings
- May have different roles/influence in Canada vs. US
- Need to consider if they want/need active role
- Role often determined by where they want to be at the end of the process
- Role of Indenture Trustee
Getting Out

- Aggregate number will dictate how much input into plan
- If bondholders staying in, will want to ensure restructuring plan is achievable to avoid a similar insolvency situation down the road
- Will want to understand the business of the debtor
Corporate Trust
Cross Border Issues
2018 Supreme Court Reference on Pan-Canadian Securities Regulation

- Under Canadian constitution the provinces jurisdiction over property and civil rights, while the federal government has jurisdiction over trade and commerce
- Various provinces began to establish securities commissions in early 1900's
2018 Supreme Court Reference on Pan-Canadian Securities Regulation

- British Privy council in *Lymburn and Mayland*, [1932] A.C. 318 (at the time this was the court of final jurisdiction in Canada) held that property and civil rights included securities regulation and therefore the provincial securities commissions were constitutional.

- The result is we have 13 provincial or territorial securities commissions and no federal regulator – this is unique among the world.
2018 Supreme Court Reference on Pan-Canadian Securities Regulation

- Important to note that the regulators have enacted a number of national, multilateral and local rules and policies that seek to harmonize the rules across the country and they do cooperate – however, system has been seen as less than ideal

- Federal government and certain provinces have sought to develop a national regulator – Ontario and BC tend to be in favour, Quebec and to an extent Alberta have been opposed
2018 Supreme Court Reference on Pan-Canadian Securities Regulation

- **Reference re Securities Act – 2011**
  - Federal government proposed a federal regulator – both Quebec and Alberta opposed this
  - Supreme Court ruled that federal government did have jurisdiction over certain aspects of securities laws, however, the national regulator as envisioned by the securities act was unconstitutional
2018 Supreme Court Reference on Pan-Canadian Securities Regulation

- Fast forward to 2018
  - Several provinces and federal government cooperated to try and create a Cooperative Capital Markets Regulatory System - British Columbia, Saskatchewan, Ontario, New Brunswick, Prince Edward Island, Yukon and federal government signed onto a Memorandum of Understanding
  - Quebec was opposed to this
  - Supreme Court held that the cooperative model as outlined in the Memorandum of Understanding was constitutional
  - At this stage it seems like this has become more a political issue than a legal issue
  - It does not look like the federal government is going to be ‘pressing’ this issue any time soon
2019 Redwater Case


- Bankruptcy in Alberta’s oil patch

- Prior to the decision, trustees entitled to sell all economic oils and disclaim uneconomic wells without paying or accounting for the cost to clean them up
2019 Redwater Case

- SCC ruled that while trustees will not be personally liable for abandonment and reclamation obligations, the estate will remain liable for such obligations.

- Reclamation and abandonment liabilities must be dealt with before there can be any distribution to the insolvent party's creditors, including its secured creditors – reclamation will now become part of the cost of doing business – will possibly make it harder for oil patch producers to get lending etc.
Enhance Public Company Disclosure

- *Katanga Mining Ltd.* (OSC, 2018) Settlement
  - Misleading continuous disclosure re mine production and financial performance plus internal controls failures and weak corporate governance
  - ‘Directors and officers set the ‘tone from the top’ and are responsible for establishing and enforcing a culture of compliance’
  - Individual sanctions ranged from $350,000 to $2.45 million and bans on acting as O&D for 2 to 6 years
Enhance Public Company Disclosure

- *Sino-Forest (OSC, 2018)*
- Misleading disclosure, company ended up bankrupt
- OSC found that CEO failed to set the proper ‘tone at the top’
- Individual sanctions from $2 million to $5 million
Cannabis

- Canada became the second country in the world to legalize cannabis for recreational use in October 2018 (Uruguay was the first country).
- Canada saw an increase of cannabis-related issuers coming to market in the last half of 2016 – this ramped up through to the end of 2018.
Cannabis

- Conflict of laws in the US between some states legalizing cannabis for either medicinal or recreational use while cannabis is illegal at the federal level – legal either medicinally or recreationally in 31 states plus the District of Columbia
In 2013, Attorney General James Cole issued ‘Cole Memo’ that stated that although cannabis was illegal at the federal level, the federal government had more important issues to deal with than enforcing this law in states where cannabis use was legal.
Cannabis

- In early 2018, Attorney General Jeff Sessions issued ‘Sessions Memo’ that rescinded the Cole Memo and stated federal government considered cannabis a dangerous drug and would enforce the laws accordingly.
Cannabis

- This caused uncertainty in the industry – producers with US assets or operations found it harder to raise funds – TSX announced that it would not list any new cannabis companies with US assets or operations and could potentially delist existing companies with US operations – lead to companies having to divest of US operations – some done in creative ways (eg transfer assets into new corp and issue options back to parent that are only exercisable and have any value if federal law in US changes)
Cannabis

- In late 2018, US did legalize industrial hemp – the non-drug portion of cannabis plant
- Smaller Canadian Securities Exchange does not share the TSX’s position on issuers with US operations – right now the CSE has 124 listed cannabis related issuers
- Given how emerging this sector is there is potential for Canada to gain first mover advantage in this space
Canadian Regulatory Framework
Canadian Regulatory Framework

- Bank Act

- Canadian Securities Administrators (CSA)
  - Canadian securities laws regulated on a provincial and territorial basis
  - No single national regulator
  - 13 securities commissions
  - Harmonized securities regulation through National Instruments (but not always)

- Main Canadian Stock Exchanges
  - Toronto Stock Exchange (TSX)
  - TSX Venture Exchange (TSX-V)
  - Stock exchanges have their own rules in addition to securities laws
Distributing Securities in Canada

- **Prospectus requirement**
  - Issuer must file a prospectus or have a prospectus exemption available

- **Dealer requirement**
  - Dealer must be registered in Canada or have a dealer registration exemption available

- **Exemptions needed from both prospectus and registration requirements**
  - Use of “accredited investor” prospectus exemption is common
  - Use of “international dealer” registration exemption is common
Accredited Investor Prospectus Exemption

- Includes certain financial institutions, government agencies, pension funds, mutual funds and sophisticated individuals
- Purchaser must purchase as principal
- No minimum purchase
- Restrictions on re-sale
- Specific Canadian disclosure (often in form of “wrapper”) required, absent available exemption
- Post-trade reports filed and fees paid within 10 days of closing (annual reporting if issuer is an investment fund)
Specific Debt Exemptions

- Securities legislation provides registration and prospectus exemption for:
  
  - Debt securities of, or guaranteed by, a bank (including a Schedule III bank), trust, loan or insurance company authorized to carry on business in Canada, other than debt securities subordinated to deposits
  
  - Debt securities of or guaranteed by a foreign government if the debt has a designated rating (all single A or higher)
  
  - Debt securities of or guaranteed by certain supranational agencies (e.g. EBRD, IFC), if the debt is payable in CAD or USD

- No prospectus, wrapper or dealer registration required
Canadian Wrappers for Foreign Offerings

- If offering is marketed using a term sheet describing the features of the securities, no Canadian specific disclosure is required.
- Canadian specific disclosure required if document describing the business and affairs of the issuer is sent to Canadian investors.
- Canadian specific disclosure includes underwriter conflicts of interest and statutory rights of rescission or damages.
Canadian Wrappers for Foreign Offerings

- Time and costs associated with preparing a Canadian wrapper resulted in Canadian investors being excluded from offerings by foreign issuers.
- In September 2015 an exemption rule was introduced to allow dealers to offer foreign securities without a wrapper on certain conditions.
Canadian Wrapper Exemptions for Foreign Offerings

- Rules provide relief for two types of foreign offerings:
  - securities issued or guaranteed by the government of a foreign jurisdiction; and
  - securities issued by a foreign issuer
Canadian Wrapper Exemption for Foreign Non-Government Securities

- Underwriter must be registered as a dealer in Canada or an exempt international dealer
- Distribution must be offered primarily outside Canada
- Issuer must be non-Canadian, must not be a reporting issuer in Canada and must have its head office and a majority of directors and executive officers resident outside of Canada
Canadian Wrapper Exemption for Foreign Non-Government Securities (continued)

- Distribution in Canada must be made only to investors who are “permitted clients”
- Underwriter must send a notice to the investor regarding use of the exemption
- Underwriter conflict disclosure (if any) must comply with FINRA Rule 5121, if applicable
- If underwriter conflicts exist, a concurrent offering must be made in the United States (e.g. registered, 144A) and Canadian investors must receive the same disclosure as US investors
“Permitted Clients”

- Largely a subset of “accredited investors”
  - **Institutional investors**: governments, financial institutions, pension funds
  - **Investment funds**, if investment fund manager or adviser is registered under securities legislation of a jurisdiction of Canada
  - **Registered advisers**, including exempt market dealers
  - **Corporations or trusts** with net assets of at least $25 million
  - **High-net-worth individuals or holdcos**, with net realizable financial assets > $5 million
  - **Some charities**
  - **Entities that only distribute to permitted clients**
Definitions Relevant for International Dealers

- **“Canadian security” vs. “foreign security”**
  - Based on domicile of issuer, not currency nor trading market
    - NYSE-listed stock of an issuer incorporated in Alberta is a “Canadian security”
    - CAD$ Maple bond of a US bank is a “foreign security”

- **“Trade” or “trading”**
  - This includes not only a sale of a security, but also any act, advertisement, solicitation, conduct or negotiation directly or indirectly in furtherance of a sale
Permitted Activities of International Dealers

- Activities reasonably necessary to facilitate distribution of securities offered primarily in a foreign jurisdiction
- Distribution to Canadian permitted clients of debt securities offered primarily in a foreign jurisdiction and for which a prospectus has not been filed in Canada
- Secondary market trading in foreign debt securities with Canadian permitted clients
Permitted Activities of International Dealers (continued)

- Trading in foreign securities with a Canadian permitted client, except in the course of a prospectus distribution in Canada
- Trading in foreign securities with a Canadian investment dealer
- Trading in any securities with a Canadian investment dealer that is acting as principal
International Dealer Restrictions

- An exempt international dealer may NOT:
  - sign a Canadian prospectus
  - distribute any securities (including foreign securities) that are qualified for distribution under a prospectus filed in Canada
  - trade with Canadian investors in any Canadian securities, whether new issue or secondary market (except government debt or limited new issue debt)

- Canadian debt new issue exception:
  - exempt international dealers may distribute to Canadian investors only as part of an offering being made primarily outside Canada
How Does This Affect Foreign Offerings into Canada?

International dealers can underwrite offerings of foreign securities

- **Private Placements in Canada**
  - Directly sell foreign securities to permitted clients or
  - Indirectly sell them through Canadian investment dealers or exempt market dealers or restricted dealers acting as agent
  - A foreign public offering is still a “private placement” in Canada unless a Canadian prospectus is filed

- **Public Offerings in Canada**
  - Indirectly sell them through Canadian investment dealers to retail public by prospectus filed in Canada
Bank Act Restriction

- Foreign banks and their affiliates are subject to a broad prohibition when dealing with Canadians:

510 (1) Except as permitted by this Part [XII], a foreign bank or an entity associated with a foreign bank shall not:

(a) in Canada, engage in or carry on

(i) any business that a bank is permitted to engage in or carry on under this Act, or

(ii) any other business;

(b) maintain a branch in Canada for any purpose
Bank Act Restriction (continued)

- This broad prohibition captures:
  - Foreign banks
  - Entities associated with foreign banks, such as securities dealer affiliates of foreign banks
  - Conduct of agents and nominees in Canada, which is attributable to the foreign bank or the entity associated with foreign bank

- The Bank Act restriction applies federally and is distinct from the provincial restrictions under securities legislation
Bank Act Restriction (continued)

- **Fact specific determination**
  - Physical premises in Canada?
  - Employees in Canada?
  - Employees visiting Canada?
  - Credit decisions or other material decisions made in Canada?
  - Negotiations in Canada?
  - Execution and/or delivery of contracts in Canada?
  - Service-providers in Canada?
  - Promotional, marketing or advertising activities in Canada or directed at Canadians
  - Secured property situated in Canada?
  - Bank accounts in Canada?
  - Other touch points in Canada?
Biographies
Janis Penton recently joined the faculty of the USC Gould School of Law where she is currently teaching ‘Regulation of Financial Institutions.’

Previously, she was the Associate General Counsel of MUFG Union Bank where she supported business units providing trust, custody, escrow and agency services to institutional customers including representing the Bank as trustee counsel on all public finance issuances and handling administrative issues, defaults and disputes on all debt issuances where the Bank acted as trustee or agent.

**Affiliations:**
- Director of Programming, ABA Trust Indenture and Indenture Trustee Committee
- Vice-Chair, ABA Law School Teaching Subcommittee
- Fellow, American College of Commercial Finance Lawyers
- Advisory Board, USC Gould Transnational Center for Law and Policy
- Past Chair, ABA Trust & Investment Services Subcommittee
- Past Chair, ABA Letter of Credit Subcommittee
- Chair, Working Group on International Letters of Credit and Bank Guarantees
- Secretary, Taskforce on the Revision of U.C.C. Article 5
Mary Buttery has gained national recognition for her involvement in countless significant insolvency files and many prominent litigation matters.

Specializing in the area of commercial insolvency and complex, multi-party litigation, Mary represents financial institutions, debtors and creditors, receivers and trustees in matters related to debt restructuring, corporate reorganizations, loan workouts, fraudulent preference actions, bankruptcy and receiverships.

Mary has extensive experience in many different sectors, most notably, mining, retail, real estate, forestry and natural resources.

She has also served as counsel in class action matters involving automobile wire harnesses and lithium ion battery price fixing.

Mary regularly advises clients who are experiencing financial difficulty, or whose customers’ or suppliers’ insolvency affects their business. In addition, Mary is an experienced commercial litigator, with expertise in the enforcement of foreign judgments, debt enforcement and fraud. She has appeared in all levels of the Ontario and British Columbia courts, the Federal Court, and has been lead counsel in the Supreme Court of Canada.
Scott Markham

General Manager

Corporate Trust, Computershare

Computershare is a global leader in transfer agency, employee equity plans, stakeholder communications, and other diversified financial and governance services.

Founded in Melbourne in 1978, Computershare entered the U.S. market in 2001 with the acquisition of the registry business of Harris Bank in Chicago, and has since grown into the world's foremost transfer agent and investor services provider.

Computershare became a publicly traded company (ASX: CPU) in 1994 with an initial market value of $25 million, growing over the years to today's market value of nearly $6 billion.

Now operating in more than 20 countries with 16,000 employees, their growth has been focused on providing opportunities for companies to attract, engage and manage their diverse stakeholder bases – individual and institutional investors, members, employees and customers – wherever they are in the world.
Vladimir Shatiryan
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Vladimir's practice focuses on a broad range of issues impacting Canadian and foreign financial institutions, including banks, insurance companies, credit unions, financial market infrastructures and payment service providers. He advises on business and ownership structures, establishment of financial institutions and foreign bank branches, cross-border banking rules, permitted investments and activities, bank resolution and recovery laws, regulatory compliance management and governance, payment clearing and settlement laws, and other regulatory issues.

Vladimir also has expertise in all aspects of Canada's anti-money laundering legislation and sanctions legislation. Vladimir has completed a secondment at the Legislation and Approvals Division of Canada's federal banking regulator, the Office of the Superintendent of Financial Institutions. Vladimir is a member of the Canadian Bar Association and associate member of the Banking Law Committee of the American Bar Association.
Thank you!

Questions?

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