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Changes to the TSXV's Capital Pool Company Program and Policy 2.4

Sean Maniaci, Shannon Scrocchi

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In December 2020, the TSX Venture Exchange (the TSXV) announced that it would be updating the policies that governed the Capital Pool Company (CPC) program. Specifically, the TSXV set out a number of changes (the CPC Policy Changes) to TSXV Policy 2.4 (the Previous CPC Policy) based on feedback and input that the TSXV had received from market participants since the Previous CPC Policy was released in June of 2010. The CPC Policy Changes took effect on January 1, 2021, with the goals of (i) increased flexibility, (ii) reduced regulatory burdens, and (iii) improved economics.

The CPC program offers Canadian private companies a unique two-step introduction to the capital markets, often used as an alternative to the more traditional initial public offering (IPO) process. The first step involves forming the CPC and listing it on the TSXV. In order to qualify for listing as a CPC, the company must have no assets other than cash and no commercial operations. The second step in the process involves the CPC identifying a suitable private operating company (a Target Company) with which to complete a qualifying share or asset transaction (a QT). The issuer resulting from the QT (the Resulting Issuer) continues trading as a Tier 1 or Tier 2 issuer on the TSXV. Since the inception of the CPC program in 1986, there have been over 2,600 CPCs created and over $75 billion of equity capital raised through the program.

This article seeks to highlight the key CPC Policy Changes, while also providing additional guidance to private companies that are looking to list on the TSXV using the CPC Program.

Any capitalized terms not specifically defined herein have the meaning given to them in the TSXV's Corporate Finance Manual, including TSXV Policy 2.4 and all applicable amendments and forms thereto.

Relaxation of Timing Restrictions

The CPC Policy Changes aim to relax the timing restrictions that were previously placed on founders of CPCs to complete a QT. Under the Previous CPC Policy, if a QT was not completed within 24 months from the date of listing, the CPC risked having its shares suspended from trading, delisted from the TSXV or, subject to the approval of the shareholders, transferred to the NEX Board of the TSXV or having 50% of the pre-IPO Seed Shares cancelled. The CPC Policy Changes remove the 24-month deadline and provide no further restrictions on the timing of a QT.

By removing the 24-month deadline, CPCs and their founders are given greater flexibility to seek out quality Target Companies and ensure that any proposed QTs are in the best interests of the shareholders, alleviating previous pressures to enter into QTs simply to avoid having shares delisted or cancelled.

The removal of the 24-month deadline also prompted changes to the policies restrictions on non-QT related expenses. Previously, Policy 2.4 restricted the permitted general and administrative expenses of any CPC to the lesser of (i) $210,000; and (ii) 30% of the gross proceeds raised by a CPC. With the removal of the 24-month deadline, the CPC Policy Changes have also replaced the previous restrictions on general and administrative expenses with a new limit of $3,000 per month, with no cumulative maximum.

Increased Incentives and Compensation Securities

The CPC Policy Changes have also increased potential incentives for directors, officers, technical consultants and Agents, by updating the restrictions surrounding CPC Stock Options and Agent's Options. Whereas under the Previous CPC Policy, CPC Stock Options could not be issued at a price lower than the IPO Price, the CPC Policy Changes now allow a CPC to grant CPC Stock Options before the IPO at a price that is not less than the lowest price at which Seed Shares were issued, so long as any CPC Stock Options issued below the IPO price remain subject to the escrow terms, as further described below.

The CPC Policy Changes also provide further incentives to Agents by lessening the restrictions on the terms of Agent's Option. Under the Previous CPC Policy, Agent's Options were limited to a 2-year term. This has been updated under the CPC Policy Changes to now allow for up to a 5-year term.

Increased Flexibility for Funding and Expenditures

The CPC Policy Changes allow for an increase in certain funding limits, including the maximum Seed Capital raised below the IPO price and the maximum aggregate funds raised by a CPC. Previously, CPCs were permitted to raise a maximum of $500,000 in Seed Capital below the IPO price. The CPC Policy Changes have increased this threshold significantly to $1,000,000. Similarly, the maximum aggregate funds that a CPC is permitted to raise has been increased from $5,000,000 to $10,000,000.

Changes to Escrow Terms

The CPC Policy Changes have amended the escrow terms that are to be applied to Seed Shares and stock options. The Previous CPC Policy required that all Seed Shares issued below the IPO price, all shares acquired from treasury by non-arm's length parties to the CPC, all shares acquired by a control person in the secondary market, and all Seed Shares issued to a member of the aggregate pro group (the Pro Group),

regardless of the price that the shares were issued at, be subject to the escrow terms set out in Policy 2.4.

Under the CPC Policy Changes, this list has been updated to remove the requirement that all shares acquired by a control person in the secondary market and all Seed Shares issued to a member of the Pro Group be held in escrow. Additionally, any shares acquired by the Pro Group as part of the QT are no longer subject to a four month hold period, unless otherwise required by law. However, as noted above, the CPC Policy Changes have also added a new requirement that CPC Stock Options and shares issued on exercise of CPC Stock Options at an exercise price below the IPO price be subject to the escrow terms under Policy 2.4.

Additionally, the escrow release terms have been updated to remove the distinction between Tier 1 and Tier 2 Resulting Issuers. Under the CPC Policy Changes, all Resulting Issuers are subject to the same 18-month escrow period, regardless of being classified as a Tier 1 or Tier 2 Resulting Issuer, with the following release schedule set out in Policy 2.4: 25% of the escrowed securities will be released on the date of the Final QT Exchange Bulletin and 25% will be released on each of the 6, 12 and 18 months following the date of the Final QT Exchange Bulletin.

The exception to these general escrow release terms being CPC Stock Options and Option Shares, which are permitted to be released on the date of the Final QT Exchange Bulletin, unless they are granted prior to the IPO, with an exercise price less than the IPO price, in which case the release schedule set out above will continue to apply.

Lower Public Distribution Requirements

Another significant change that occurred under the amendments to Policy 2.4 was the decrease in public distribution requirements for Public Shareholders and Public Float. Previously, upon completion of the IPO, CPCs were required to have at least 200 shareholders, owning at least 1,000 shares, with a Public Float of at least 1,000,000 shares. This has been decreased under the CPC Policy Changes to now require a minimum of 150 Public Shareholders, owning 1,000 shares, with a Public Float of at least 500,000 shares. Despite these changes, the policy still requires Public Shareholders to collectively hold at least 20% of the outstanding shares.

Directors and Officers

The requirements for directors and officers of CPCs and Resulting Issuers have also been updated under the CPC Policy Changes. Whereas under the Previous CPC Policy, one person was not permitted to hold the role of CEO, CFO and Secretary at one time, the CPC Policy Changes have removed this restriction and it is now at the discretion of the board of directors of each CPC to determine whether it is suitable for one

individual to hold all three officer positions.

Further, the CPC Policy Changes have reduced the residency restrictions for directors and officers of both CPCs and Resulting Issuers. Previously, all of the directors and officers of a CPC and a majority of the directors and officers of a Resulting Issuer had to be residents of Canada or the United States or had to have public company experience. The threshold for CPCs has been decreased under the CPC Policy Changes to now only require that a majority of the directors and officers meet these restrictions, while the restrictions have been removed entirely for Reporting Issuers.

These changes create additional opportunities and flexibility for CPCs and Reporting Issuers to involve international directors and officers, effectively expanding the pool of talent and experience that is available to CPCs and Reporting Issuers.

Transitional Provisions

The CPC Policy Changes contain specific transitional provisions setting out how existing CPCs, at various stages of existence, are able to take advantage of the amendments to Policy 2.4.

While CPCs are entitled, without shareholder approval, to implement most changes from the Previous CPC Policy to reflect the CPC Policy Changes, disinterested Shareholder approval is required in order to adopt any of the following list of CPC Policy Changes:

1. Removal of the previous 24-month QT deadline;
2. Extending the term of any out-of-the-money Agent's Options to a maximum of 5 years from the date of the original grant;
3. Reducing the length of the escrow terms and immediately releasing certain Common Shares from escrow to track the escrow terms permitted under the new policy;
4. Permitting payment of a finder's fee or commission to a non-arm's length party to the CPC upon completion of a QT; and
5. Adopting a rolling stock option plan that allows for the issuance of stock options equal to up to 10% of the outstanding Common Shares at the date of any stock option grant.

This publication is a general summary of the law. It does not replace legal advice tailored to your specific circumstances.