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SECURITIES & CAPITAL MARKETS BULLETIN

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TSX Guidance On Anti-Dilution Provisions, Compensation Plan Amendments and the Uptick Prohibition for NCIB Purchases

On December 7, 2009 the Toronto Stock Exchange ("TSX") staff issued a notice (the "Notice") providing guidance on:

- anti-dilution provisions for convertible securities;
- amendments to add a cashless exercise feature to security-based compensation arrangements; and
- the uptick prohibition for purchases made pursuant to normal course issuer bids.

Anti-dilution provisions

The rules of the TSX provide that anti-dilution adjustments made to convertible securities (i) for which not all security holders are compensated and (ii) which may result in securities issued at the exercise (or conversion) price lower than market price (minus the maximum allowable discount) will not be permitted, unless approved by disinterested shareholders.

The Notice provides guidance on this matter. The Notice provides that anti-dilution provisions that adjust the exercise or conversion price of a convertible security downward to match the price of securities issued at a lower price will require security holder approval (excluding the votes attached to securities held by insiders who are benefiting from the anti-dilution provisions) unless:

- in the case of warrants and options, the adjustment results in an exercise price that is not lower than the market price of the underlying security at the time when the convertible security was issued; or
- in the case of a convertible instrument (such as debentures and preferred shares), the adjustment results in a conversion price that is not lower than the market price of the underlying security at the time when the convertible security was issued less the maximum allowable discount.

Where the anti-dilution provisions result in the issuance of additional underlying securities rather than by an adjustment to the exercise or (conversion price), the TSX will apply the same requirements to the overall effective exercise or conversion price.

The Notice provides that anti-dilution provisions for stock splits and consolidations are generally acceptable if they are proportionate.

For special distributions and rights offerings, the amount of an anti-dilution adjustment generally must not exceed the difference in the five-day volume-weighted average trading price of the underlying security (the "VWAP") immediately prior to the underlying security trading on an "ex-distribution" basis and the VWAP for the five-day period following trading on an "ex-distribution" basis. Anti-dilution adjustments are not acceptable for ordinary course dividends or distributions.

The TSX expects issuers to request prior consent for:

- any participation by holders of convertible securities in regular distributions made to holders of the underlying securities;
- any amendment to a convertible security pursuant to a basket clause which provides that the board of directors (or equivalent body) can amend the exercise (or conversion) price at its discretion in the event of a dilutive event not specifically contemplated by the terms of the security; and
- any other amendment to the terms of convertible securities.

In practice, we expect that issuers will seek prior consent from the TSX before issuing convertible securities that participate in distributions along with the underlying securities, since investors may be reluctant to accept such consent as a condition to the payment of distributions. Similarly, the need to seek consent before relying on a basket anti-dilution clause will encourage the adoption of more exhaustive specific anti-dilution provisions.

Addition of a cashless exercise feature to security-based compensation arrangements

The TSX has indicated that it considers an amendment to add a cashless exercise feature to a security-based compensation arrangement, unless the cashless exercise would result in a corresponding deduction in the maximum number of securities under the arrangement, to be equivalent to an increase in the maximum number of securities issuable under the compensation arrangement. Accordingly, security holder approval would be required under subsection 613(i)(iv) of the Company Manual, notwithstanding that the compensation arrangement may include detailed amendment provisions.

NCIB price limitations

The Company Manual requires that purchases made by listed issuers pursuant to an NCIB must be at a price which is not higher than the last independent trade of a board lot of the class of securities which is the subject of the NCIB (the "uptick prohibition").

In view of the increasing speed of order entry and trade execution, which has made compliance with the uptick prohibition more difficult, the TSX will not consider trades to be a violation of the uptick prohibition, and will permit such trades to be accounted for under a NCIB, provided that:

- the independent trade occurs no more than one second before the NCIB purchase which creates the uptick;

- the independent trade is a down tick to the previous trade and the NCIB purchase would not have created an uptick to the trade prior to the last independent trade; and

- the price difference between the NCIB purchase and the independent trade is not more than $0.02.

The staff notice is available on the TSX's website here.

If you would like more information about this notice, please contact the authors or your usual lawyer in BLG's Securities & Capital Markets Group.

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