

Common U.S. Securities Problems with Canadian Stock-Based Compensation Plans

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by Christopher L. Doerksen

We are frequently asked to review Canadian companies' stock option, restricted share unit (RSU), performance share unit (PSU), deferred share unit (DSU), and other stock-based compensation plans for U.S. securities law purposes, because awards are expected to be made to U.S. residents. For companies that are cross-listed and file reports with the Securities and Exchange Commission (SEC), the intention is typically to register the underlying securities by filing a Form S-8 with the SEC. For companies that do not file SEC reports – whether publicly traded in Canada or privately held – the intention is typically to rely on the exemption provided by Rule 701 under the Securities Act of 1933 and exemptions under the securities laws of the states in which awards will be granted.

Some of the most common U.S. securities issues we see in connection with Canadian stock-based compensation plans include:

1. Defining the class of persons eligible to receive awards in a manner broader than is permitted under Form S-8 or Rule 701, especially:

- Allowing grants to consultants that are entities, or that are involved in investor relations or fundraising activities;
- Allowing grants to consultants' employees; and
- In the case of Rule 701, allowing grants to employees of subsidiaries that are not majority-owned.

2. Failing to realize when a plan is subject to U.S. securities laws and requires registration or an exemption, or the treatment of securities as restricted securities, especially:

- Plans that involve open market purchases or that otherwise involve the delivery of shares that were previously free trading, such as an open market employee share purchase plan (ESPP) or a trust funded with free trading securities; and
- Plans in which a participant elects to forego cash in exchange for a long-term investment that itself is ultimately settled in cash, such as an executive deferred

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compensation plan or a director DSU plan.

3. Unqualified covenants of the company to take all steps necessary to comply with applicable law, which could be interpreted as requiring a non-reporting company to file an SEC registration statement and become an SEC reporting company if the company has inadvertently made U.S. awards that are not exempt from registration.
4. Failing to include provisions required by U.S. state laws, when grants will be made in states that require the inclusion of specific terms in the plan.
5. In the practical aspects of plan implementation and the making of awards, including:
 - Making awards that do not comply with U.S. federal or state laws because such laws were not evaluated prior to the time of grant; and
 - Using forms of award agreement that have not been tailored for U.S. residents.