

REPORT ON ONTARIO'S NEW PROSPECTUS EXEMPTIONS AND MULTILATERAL RESALE RESTRICTIONS

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Two new regulatory developments impact "prospectus exempt" distributions of securities effected in Ontario.

On November 30, 2001, Revised OSC Rule 45-501 respecting prospectus exempt distributions (the "New Rule") replaced existing OSC Rule 45-501 (the "Old Rule") and OSC Rule 45-504 Prospectus Exemption for Distributions of Securities to Portfolio Advisors on Behalf of Fully Managed Accounts. The new exemptions, among other things, replaced the private company exemption, the private issuer exemption, the \$150,000 exemption, the seed capital exemption and the government incentive security exemption.

The New Rule includes exemptions from the prospectus requirements for the following trades effected in Ontario:

- a trade in a security of a closely held issuer (s.2.1),
- a trade in a variable insurance contract (s. 2.2),
- a trade to an accredited investor (s.2.3),
- a trade by a control person in a security acquired under a formal take-over bid (s. 2.4),
- a trade in connection with a securities exchange issuer bid (s. 2.5),
- a trade upon the exercise of conversion rights in a convertible security (s. 2.6),
- a trade upon the exercise of exchange rights in an exchangeable security (s. 2.7),
- a trade on an amalgamation, arrangement or specified statutory procedure (s. 2.8),
- a trade in a security under the *Execution Act* (s. 2.9),
- a trade to a registered retirement income fund (s. 2.11),
- certain trades in a security of a mutual fund or non-redeemable investment fund (s. 2.12), and
- a trade by a promoter or issuer in a government incentive security (s. 2.13).

Multilateral Instrument 45-102 (the "Resale Instrument"), an initiative of the securities regulatory authorities of all provinces and territories other than Quebec, also came into force on November 30, 2001. It attempts to harmonize provincial and territorial resale restrictions that apply to the first trade of securities distributed in any of the participating jurisdictions in reliance upon exemptions from prospectus requirements, including the exemptions available pursuant to the New Rule. The Resale Instrument also adopts a harmonized approach to control block distributions as well as trades involving securities of non-reporting issuers that are made through a foreign exchange or market.

NEW PROSPECTUS EXEMPTIONS

A few of the more notable new prospectus exemptions are described in detail as follows:

Exemption for a Trade to an Accredited Investor

The New Rule creates an exemption (the “Accredited Investor Exemption”) from Ontario’s dealer registration and prospectus requirements for any private placement effected in Ontario to an investor that falls within the definition of “accredited investor” and mandates new reporting requirements and the Resale Instrument imposes different, somewhat more liberal, resale restrictions. This exemption permits issuers to raise any amount at any time from any person or company that meets specified qualification criteria and there is no limit on the number of times the exemption may be used.

Accredited Investors

Under the New Rule, "accredited investors" are defined so as to include the following:

- individuals who beneficially own, either alone or with a spouse, cash, securities, insurance contracts and deposits which have an aggregate realizable value which exceeds \$1 million (before taxes but net of related liabilities);
- individuals with net income before taxes in excess of \$200,000 in each of the last 2 years (or \$300,000 with a spouse), and who have a reasonable expectation of exceeding that income level in the current year;
- corporations, partnerships, trusts or estates (other than mutual funds or non-redeemable investment funds) with net assets of at least \$5 million;
- banks (including authorized foreign banks);
- loan, trust and insurance companies;
- credit unions;
- securities advisers and dealers (other than limited market dealers);
- governments, governmental agencies, municipalities and provincial and territorial capital cities;
- regulated pension funds and registered charities;
- mutual funds or non-redeemable investment funds that, in Ontario, distribute securities under a prospectus for which a receipt has been granted or only to persons or companies that are accredited investors;
- current or former representatives of a securities adviser or dealer;
- issuers that acquire securities of their own issue;
- promoters of an issuer;
- spouses, parents, grandparents and children of an officer, director or promoter of an issuer¹;
- control persons;

¹ OSC Rule 45-503 provides an exemption for trades to employees, executives and consultants.

- a managed account acquiring a security that is not a security of a mutual fund or non-redeemable investment fund; and
- persons or companies recognized as accredited investors.

Filing and Disclosure

The sale of securities in reliance upon the Accredited Investor Exemption requires, in most cases, the filing by the issuer of a Form 45-501F1 (in duplicate) within 10 days of the sale. The filing fee, which is unchanged from that required by the Old Rule, is the greater of \$100 and 0.02% of the proceeds raised in Ontario (or, for special warrant transactions, 0.04% of such proceeds) less 20%.

In addition, under the Resale Instrument, if an issuer is a qualifying issuer and sells shares in reliance upon the Accredited Investor Exemption, it must file a Form 45-102F2 within 10 days of the sale. The filing must be done on SEDAR so that investors will be able to determine from the public record whether the applicable restricted period or seasoning period is 4 months or 12 months.

Resale

The Resale Instrument replaces the six, twelve or eighteen month hold periods previously applicable to securities issued under a private placement exemption with a four month hold period for issuers that are "qualifying issuers" on the date the securities are issued and a twelve month hold period for all other issuers.

A "qualifying issuer" is defined as a reporting issuer that has either listed equity or outstanding debt with an approved rating and a current AIF filed on SEDAR. Where an issuer is not a reporting issuer in a participating jurisdiction at the time it conducts a private placement effected within that participating jurisdiction, the twelve month hold period will not begin to run until the issuer becomes a reporting issuer in that jurisdiction. Privately placed securities sold in that jurisdiction during a hold period will be subject to prospectus requirements, unless an exemption is available.

The resale restrictions prescribed by the Resale Instrument apply to resales of securities privately placed within a participating jurisdiction whether or not the placement was effected prior to November 30, 2001.

A resale triggers a resale report to be filed within 10 days of the trade by the seller in Form 45-501F2 in duplicate accompanied by a \$100 fee.

Exemption for a Trade in Security of a Closely Held Issuer

The New Rule replaces the seed capital, private company and private issuer registration and prospectus exemptions with an exemption that applies to certain trades in the securities of a closely held issuer (the "Closely Held Issuer Exemption"). The New Rule also imposes new disclosure and filing requirements and the Resale Instrument mandates new resale rules. This

exemption permits issuers to raise a total of \$3 million, through any number of financings, from up to 35 investors (excluding employees) without concern for the "qualifications" of the investors.

Closely Held Issuer

The New Rule defines a closely held issuer as an issuer, other than a mutual fund or non-redeemable investment fund, whose

- shares are subject to restrictions on transfer requiring the approval of either the board of directors or the shareholders of the issuer contained either in its constating documents or one or more agreements to an agreement between the issuer and its shareholders; and
- outstanding securities are beneficially owned, directly or indirectly, by not more than 35 persons or companies, exclusive of (i) persons or companies that are, or were at the time they last acquired securities of the issuer, accredited investors, and (ii) current or former directors, officers, employees or consultants of the issuer or an affiliate of the issuer whose only securities of the issuer were issued as compensation by, or under an incentive plan, of the issuer or an affiliate of the issuer.

A trade in the security of a closely held issuer will be exempt from the dealer registration and prospectus requirements if:

- following the trade, the issuer will be a closely held issuer and the aggregate proceeds received by the issuer, and any other issuer engaged in common enterprise with the issuer, in connection with all trades made in reliance upon this exemption will not exceed \$3,000,000;
- no promoter of the issuer has acted as a promoter of any other issuer that has issued a security in reliance upon the Closely Held Issuer Exemption within the 12 months preceding the trade; and
- no selling or promotional expenses are paid or incurred in connection with the trade, except for services performed by a dealer registered under the *Securities Act* (Ontario).

Filing and Disclosure

No filings are required to be made and no fees must be paid in connection with a trade made in reliance upon the Closely Held Issuer Exemption.

Issuers intending to rely on the Closely Held Issuer Exemption must provide an information statement substantially similar to Form 45-501F3 to prospective purchaser at least 4 days prior to the date of the trade unless, following the sale, the issuer will not have more than 5 beneficial holders of its securities.

Resale

Securities of a closely-held issuer may be resold under the Closely Held Issuer Exemption, provided the issuer will continue to be a closely-held issuer following completion of the resale. Otherwise, the reseller must rely upon another prospectus exemption and the issuer must have been a reporting issuer for at least 12 months.

Exemption for Certain Trades in a Security of a Mutual Fund or Non-Redeemable Investment Funds

Securities of mutual funds or non-redeemable investments funds (collectively, "Pooled Funds") may be distributed in reliance upon the Accredited Investor Exemption. The OSC has also created additional dealer registration and prospectus exemptions (the "Pooled Fund Exemptions") for sales of Pooled Fund securities of non-reporting issuers that resemble the old \$150,000 exemption. Pursuant to section 2.12 of the New Rule the dealer and prospectus requirements do not apply to a trade in a security of a Pooled Fund that is not a reporting issuer if:

- The purchaser purchases as principal; either (i) the security has an aggregate acquisition cost to the purchaser of not less than \$150,000 or (ii) the security is issued by a Pooled Fund in which the purchaser then owns securities having an aggregate acquisition cost or an aggregate net asset value of not less than \$150,000; and the Pooled Fund is managed by a portfolio advisor or a trust corporation registered under the *Loan and Trust Corporations Act*; or
- The purchaser purchases as principal; the security has an aggregate acquisition cost to the purchaser of not less than \$150,000; and the Pooled Fund is managed by a person or company, not ordinarily resident in Ontario, to whom the advisor registration requirement does not apply pursuant to Part 7 of Rule 35-502 Non-Resident Advisors.

Transitional Status

The OSC has indicated in the Companion Policy to the New Rule that the Pooled Fund Exemptions are intended to be a temporary measure, to provide OSC staff with sufficient time to undertake a comprehensive review of the appropriate regulatory response regarding the exempt distribution of securities of Pooled Funds.

Filing and Disclosure

A Pooled Fund selling securities in reliance upon a Pooled Fund Exemption shall, no later than 30 days after the financial year end of the Pooled Fund in which the trade occurred, file a report, in duplicate, on Form 45-501F1. The fee that must accompany the filing is the greater of \$100 and 0.02% of the aggregate gross proceeds realized by the Pooled Fund in Ontario during the financial year less 20%.

OFFERING MEMORANDA

The New Rule replaces the statutory requirement to include contractual rights of action in an offering memorandum delivered in connection with certain prospectus exemptions with statutory rights of action.

Under the old exemption regime contractual rights of action were available not only in situations where an offering memorandum was required to be provided but also in situations where an offering memorandum was voluntarily provided in connection to certain private placement exemptions. The New Rule does not require the delivery of an offering memorandum when distributing securities in reliance upon any prospectus exemption, with the exception of the exemption available for government incentive securities. If an offering memorandum is delivered voluntarily in connection with a trade made in reliance upon the following prospectus exemptions, the statutory rights of action will apply:

- Accredited Investor Exemption;
- Closely Held Issuer Exemption;
- Pooled Fund Exemption; and
- Government Incentive Security Exemption.

If the statutory rights of action apply, they must be described in the offering memorandum. In the Companion Policy to the New Rule, the OSC advises that the only document other than the offering memorandum that should be distributed to prospective investors is a “term sheet” (representing a skeletal outline of the features of an issue without dealing extensively with the business and affairs of the issuer). However, if preliminary offering materials are distributed in Ontario, the OSC warns that those materials must contain a description of the statutory rights of action available to purchasers in situations when the statutory right of action applies and a description is required. The statutory right of action and the requirement to include a description of the right of action also applies to offerings made in Ontario by foreign issuers.

Filing and Delivery

The definition of "offering memorandum" in the Act continues to apply. Generally, an offering memorandum is any document purporting to describe the business and affairs of an issuer, prepared primarily for delivery to and intended to be reviewed by a prospective investor.

Pursuant to section 4.3 of the New Rule, if an offering memorandum is delivered to prospectus purchasers in connection with the Accredited Investor Exemption, the Closely Held Issuer Exemption or the Pooled Fund Exemptions, the offering memorandum must be delivered to the OSC within 10 days of the trade.

OTHER CANADIAN JURISDICTIONS

The New Rule applies only in Ontario.

The Alberta Securities Commission (“ASC”) and the British Columbia Securities Commission (“BCSC”) have published for comment Multilateral Instrument 45-103 Capital Raising Exemptions (“MI 45-103”) which aims to harmonize the prospectus and registration requirements in Alberta and British Columbia.

The proposed capital raising exemptions are as follows:

- Private Issuer Exemption;
- Family, Friends and Business Associates Exemption;
- Offering Memorandum Exemption; and
- Accredited Investor Exemption.

The definition of “accredited investor” proposed under the accredited investor exemption will be substantially the same as the definition provided by the New Rule in Ontario. Issuers will not be required to provide an offering document to accredited investors. If one is provided, it will not be required to be in a prescribed form or to provide rights of action. Advertising to accredited investors will be permitted and will not trigger an obligation to provide an offering document or rights of action. Issuers will be required to file reports in the prescribed form for trades made under the accredited investor exemption.