

Corporate Securities

MAY 22, 2001

Proposed Changes to Private Placement Rules in Ontario

The Ontario Securities Commission recently published for comment a revised proposal designed to bring about significant changes in Ontario's private placement rules. The proposal is the manifestation of the OSC's public commitment to reconstruct the current regulatory scheme in order to facilitate efficient capital formation by small and medium-sized businesses while maintaining adequate investor protection. The changes for private placement in Ontario will be significant and are expected to be implemented in 2001.

The proposed rule would create two new prospectus exemptions, which would replace certain of the current exemptions:

- *The Closely-Held Issuer Exemption* would replace the current "private company exemption" and the "private issuer exemption" and would allow "closely-held" issuers (essentially issuers with thirty-five or fewer securityholders with restrictions on the transfer of securities) to raise a lifetime limit of \$3,000,000 from up to thirty-five investors (excluding employees, consultants and accredited investors).
- *The Accredited Investor Exemption* would replace a number of current exemptions, including the popular \$150,000 exemption, by allowing issuers to raise any amount of funds on an exempt basis provided that the investors qualify as "accredited investors".

Closely-Held Issuer Exemption

The proposed "closely-held issuer exemption" is designed to facilitate financings of issuers at early stages. The exemption would allow issuers to raise up to a lifetime maximum of \$3,000,000 through any number of financings from up to 35 investors, exclusive of employees, consultants and accredited investors. There are no restrictions on who may qualify as a purchaser for the purposes of this exemption such that any person may invest regardless of their financial circumstances or their level of sophistication. Although the use of advertising and the involvement of a registered dealer are not prohibited in connection with a financing made in reliance on the exemption, as a practical matter advertising and dealer involvement could not be utilized (which is consistent with the conception of the exemption as being used for early stage private transactions) because the terms of the exemption prohibit the issuer from paying or incurring selling or promotion expenses. Where an issuer relying on the exemption would have more than five securityholders following the distribution, the issuer would be required to provide prospective investors with an information statement in prescribed form.

Accredited Investor Exemption

The accredited investor exemption would allow an issuer to raise any amount of funds from any number of investors provided that those investors qualify as "accredited investors". The premise of the exemption is that certain classes of persons have sufficient sophistication (which for this purpose generally means the ability to withstand the loss and sufficient experience or access to expertise to permit a proper evaluation of the investment opportunity) so as not to require the protections of a prospectus.

Accredited investors would include prescribed financial institutions, charities or pensions; registrants (other than limited market dealers); gov-

ernment agencies; individuals who (either jointly or with a spouse) own financial assets with an aggregate realizable value (before taxes but net of any related liabilities) exceeding \$1,000,000; individuals whose net income before taxes exceeded \$200,000 or whose net income before taxes together with his or her spouse exceeded \$300,000 in each of the past two years and who have a reasonable expectation of exceeding such income level in the current year; officers, directors or promoters of the issuer; a spouse, parent, grandparent or child of an officer, director or promoter of the issuer; affiliates of the issuer; the issuer; an entity (other than a mutual fund or non-redeemable investment fund) with net assets of at least \$5,000,000; a person or company recognized by the OSC as an accredited investor; and mutual funds or non-redeemable investment funds that distribute securities only to accredited investors or under a prospectus for which a receipt has been issued.

There is no requirement under the proposed accredited investor exemption to deliver any disclosure document to prospective purchasers. Where an issuer voluntarily provides an offering memorandum, however, the issuer will be required to provide a statutory right of action, allowing purchasers to assert a right of rescission or a claim for damages for any misrepresentation contained therein.

Impact and Next Steps

The proposed rule would have the benefit not only of significantly modernizing and simplifying the private placement regulatory framework in Ontario, but would have the additional benefit of creating significant congruity between Ontario's private placement rules and analogous U.S. requirements.

Related Initiatives

The proposed restructuring of the private placement exemptions is occurring at the same time as regulatory initiatives to update the hold period rules that apply to privately placed securities. Under an initiative of all of the provincial securities regulators, the resale restrictions applicable to exempt offerings (i.e. the "hold periods") would be harmonized throughout the provinces, other than Quebec. (The proposed changes in the private placement exemptions which would apply only in Ontario). This initiative is proposed to be implemented as early as June 29, 2001. Under the new system the hold periods, which are presently six, twelve or eight-

een months long, would be four months for "qualified issuers" and twelve months for other issuers. A "qualified issuer" is essentially an issuer with current public disclosure (specifically a current annual information form) and either a listing on a recognized exchange or an approved rating. This change would in many circumstances significantly shorten hold periods resulting from the private issuances of securities.

Our partner Neill May has been engaged by the Ministry of Finance through the OSC to provide advice on certain elements of the proposed revised rule. We encourage you to contact us if you would like to discuss the proposal or if you would like help in preparing comments for the OSC.

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