nmay@goodmans.ca

Perpetual private placement permutations

By Neill May

If it seems as though changes to the private placement rules are occurring on a more or less continuous basis, it's because they are. It is tempting to think of this in terms of *Groundhog Day*. To me, though, the seemingly constant changes bring to mind the comments of the patriarchal grandfather in the movie *Parenthood* to one of his sons, describing how parental responsibility for children doesn't end when those children pass into adulthood: "It never ends. It's like your Aunt Edna's ass. It goes on forever and it's just as frightening. There is no end zone. You never cross the goal line, spike the ball, and do your touchdown dance. Never."

There are, however, good reasons for the recurring reformulations. Exemptions permit distributions of securities, which would normally require that a prospectus be prepared and cleared by regulators, to be completed without a prospectus. The core principle is that exemptions should apply where the protections of a prospectus (primarily disclosure, and potential liability for disclosure failures) are not required. Not an easy equation to solve.

For one thing, it begs the difficult question of when a prospectus is "necessary." Is it a function of the investor's wealth (as an indication of an investor's ability to withstand loss and/or access to expert advice), education and experience, and/or the size of the proposed investment? If so, then what thresholds are sufficient, and should they change over time to take into account inflation and other factors? The regulators' challenge is further complicated by the added nuance of seeking a balance between facilitating capital raising (particularly by early-stage businesses) on the one hand and investor protection on the other.

The complexity is compounded by other factors. One challenge is harmonization, the degree to which the same rules apply across the provinces and territories (and, for that matter, national borders). Private placements often occur in multiple jurisdictions, so there are significant efficiencies from regulatory alignment. But different markets may have different characteristics, and regulators themselves may have different perspectives and experiences, which would trend toward jurisdictional differences.

Another challenge is that markets themselves are constantly changing; when the private placement framework was first implemented nobody (with the possible exception of Al Gore) would have conceived of the immediate availability of information and universal access to markets through computers, or phenomena such as crowdfunding. The rules too have evolved, with statutory liability for an issuer's ongoing disclosures, not just for the prospectus.

Yet another factor is inertia: investors and market professionals have familiarity and practices tied up in the structure of current exemptions, creating resistance to dramatic change.

The amendments recently made to the rules, and currently proposed, reflect these factors in varying degrees. Three changes are being made to national rules. First, the "minimum investment exemption," which exempts distributions involving an investment of at least $150,000, is to be amended to prohibit its use for distributions to individuals. This exemption, which has occasionally raised questions because its effect may be to compel investors to invest more than they otherwise might, has been around for almost 30 years (without the dollar value having changed, notwithstanding inflation in the interim). Second, the "accredited investor exemption," which exempts distributions to investors with characteristics considered to reflect the sophistication necessary not to require the protection of a prospectus, is to be amended to require investors to sign a risk acknowledgment form. Third, the rules concerning exempt distributions of short-term debt are being refined, including the creation of a new exemption for short-term securitized products.

Ontario also took steps to increase (though not completely achieve) harmonization, adopting exemptions that are substantially similar to rules in other Canadian jurisdictions. First, the Ontario Securities Commission is implementing a "family, friends, and business associates exemption" that permits distributions to investors deemed to be close enough to the issuer to not require a prospectus (and which is broader than Ontario's current "founder, control person, and family exemption").

The OSC has also adopted an exemption for public issuers whose securities are listed on certain exchanges to raise capital from existing investors, subject to certain limits (meaning that for certainly publicly traded issuers, investors can invest without limits through a stock exchange without a prospectus, but can only do so subject to limits under a private placement).

The OSC is also planning to publish this summer updated and possible final versions of two other proposed new prospectus exemptions: an offering memorandum exemption (which already exists in other Canadian provinces) and a crowdfunding exemption (to specifically address securities offerings through that platform).

On this topic the groundhog has emerged from his or her lair, spotted the shadow, and predicted many more rounds of reflection on the private placement rules. Assuming that if the groundhog knew of the perfect and eternal solution he or she would have simply provided it (for a reasonable fee), and given the factors referenced, a perpetual season of reformulation is probably an okay thing. **CL**

Neill May is a partner at Goodmans LLP in Toronto focusing on securities law, with an emphasis on M&A and corporate finance. The opinions expressed in this article are those of the author alone.