

May 19, 2004

2004 Ontario Budget: Government Support for Venture Capital Investment

Following the lead of the Federal Government's recent Budget announcement, the Ontario Government Budget of May 18, 2004 reaffirmed the importance of venture capital to economic growth and announced two sources of new funding to encourage venture capital investment in the commercialization of research and development in Ontario:

- A new Ontario Research Commercialization Program to provide \$27 million over four years in "proof of principle" funding to help public research institutions attract pre-seed investment.
- A new Ontario Commercialization Investment Funds program, to provide a maximum of \$36 million to supplement new pools of seed capital for investment in spin-off technology companies arising from scientific research at Ontario public sector research institutions.

Venture capital fund managers and Angel investors should remain alert to these developments and the potential opportunities to obtain matching funding for new funds or investments targeting the commercialization of scientific research.

The Government also announced important changes to the Labour Sponsored Investment Fund program and technical amendments to the *Community Small Business Investment Funds Act*.

The two announced programs, described below, are intended to ensure that Ontario's high level of scientific output will reach its commercialization potential.

The Budget acknowledges that despite significant public investment in R&D, there is a role for government to encourage the investment of private capital to support the growth and development of entrepreneurial technology firms derived from this research. To strengthen the ability of research institutions to access private capital, the government has pledged to support investment where a gap currently exists in the supply of venture capital: earlier stage, higher-risk technology businesses, particularly those resulting from research in universities and hospitals.

Ontario Commercialization Investment Funds Program

The Budget commits to the creation of a new grant program to fund costs associated with bringing innovation to market. Under the new program, the government will provide a maximum of \$36 million over four years, designed to leverage up to \$120 million in private capital, into new seed capital funds investing in spin-off technology companies arising from scientific research at Ontario research institutes. Ontario Commercialization Investment Funds (OCIF) will be entitled to grants of up to 30% of eligible investments made in a year, to the extent that investments are supported by new capital raised by the OCIF.

To qualify for the program, OCIFs must be sponsored by an eligible institution and are to be capitalized from institutional, corporate and accredited individual investors. Each research institute that qualifies under the Ontario Research-Business Institute Tax Credit (including universities, colleges of applied arts and technology, Centres of Excellence and hospital research institutes in Ontario) may sponsor one OCIF. Eligible investments must be risk-capital – businesses receiving investments must not have established commercial operations, must have less than \$1 million in assets at the time of the investment and must need financing for research and product development. To be considered an eligible investment, a strong link to the intellectual property of the sponsor is also required. OCIFs must diversify their investments and will be prohibited from paying dividends or redeeming shares within four years of being created.

Goodmans^{LLP} Update

The Ontario Government has indicated that it will introduce legislation to create the OCIF program following consultations with the Federal Government and other interested parties. It also announced that it will work with the Federal Government to maximize Ontario's participation in the venture capital initiatives announced in the 2004 Federal Budget.

Ontario Research Commercialization Program

Through the Budget, the Ontario Government announced that it will refocus its current innovation programs towards commercialization of scientific research. Although the details have not yet been specified, the second source of new funding committed in the Budget is a new Ontario Research Commercialization Program. This program will provide \$27 million over four years in "proof of principle" funding to help public research institutions attract pre-seed investment.

Changes to the LSIF and CSBIF Programs

The Ontario Government has announced that effective immediately, it has imposed a moratorium on registrations of any new Labour Sponsored Investment Funds (LSIFs). This moratorium will not effect existing LSIFs.

The Budget also announced amendments to the existing rules governing LSIFs, including:

- rules allowing the amalgamation of LSIFs through asset purchases;
- providing LSIFs with the ability to offset 70% of realized losses deducted from investment requirements with a maximum of 70% of realized gains, a change designed to assist LSIFs which currently face increasing investment requirements but are capped or have no new capital to invest; and
- the restriction on LSIF investments in companies listed on a stock exchange will be relaxed so that an LSIF can invest up to 25% of its investments in a year in listed companies.

Investors involved in Community Small Business Investment Funds should also be aware that several technical amendments have been proposed as part of the government's ongoing evaluation of the *Community Small Business Investment Funds Act*.

Additional Perspective

We have actively participated in discussions over the past several months with Governments, VC funds, institutional investors and the scientific research community in relation to the creation of new funding programs to address the early-stage financing gap for commercialization of scientific research. We continue to be involved in this process and would be happy to provide additional perspective on these issues to any interested clients and friends.

Please contact Rick Nathan, Managing Director of Goodmans Venture Group, if you would like to stay informed on new developments in this area, or if you would like any additional information on these issues.

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