

Corporate Securities

OCTOBER 2, 2001

Dramatic Changes to Private Placement Rules in Ontario

Ontario's private placement rules will change significantly this fall. Final versions of the new rules governing private placements and hold periods have now been released and, provided the Minister of Finance does not object, will be implemented effective **November 30, 2001**. The new rules (which have been revised since the earlier draft proposals described in our Corporate Securities Update dated May 22, 2001) will dramatically change the regulatory framework for prospectus-exempt financings in Ontario.

New Exemptions

The new version of Rule 45-501 will replace certain widely used exemptions, including the private company exemption and the popular \$150,000 exemption, and in their stead create two new prospectus exemptions:

- *The Closely-Held Issuer Exemption*, which will 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, directors, consultants and accredited investors).
- *The Accredited Investor Exemption*, which will allow issuers to raise any amount of funds on an exempt basis provided that the investors qualify as "accredited investors".

Closely-Held Issuer Exemption

The "closely-held issuer exemption" is designed to facilitate financings of issuers at early stages. The exemption will allow issuers to raise up to a lifetime maximum of \$3,000,000 through any number of financings from up to 35 investors (regardless of their financial circumstances or their level of sophistication), exclusive of current or former employees, directors, officers and consultants (so long as they acquired their securities as compensation under an incentive plan of the issuer or its affiliates) and accredited investors. The closely-held issuer exemption is not available to a mutual fund or non-redeemable investment fund.

Although the use of advertising will effectively be prohibited in connection with a financing made in reliance on the exemption (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, issuers can utilize the services of a registered dealer in order to facilitate financings under the exemption.

Where an issuer relying on the exemption would have more than five beneficial securityholders following the distribution, the issuer will be required to provide prospective investors with a one-page information statement in prescribed form (addressing matters such as the risks of investment and the considerations that should be entertained prior to investment) at least four days before the trade. In addition, if an offering memorandum (meaning any document purported to describe the business and affairs of the issuer prepared primarily for delivery to and review by prospective investors other than a document setting out current information about an issuer for the benefit of a purchaser familiar with the issuer through prior investment or business contact) is provided to investors, then investors will have a statutory right of action for rescission or damages if there is any mis-

THE UPDATE

representation contained therein, which right of action must be described in the offering memorandum.

Accredited Investor Exemption

The accredited investor exemption will allow issuers 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 include prescribed financial institutions, charities or pensions; registrants (other than limited market dealers); government 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; 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 itself; an entity (other than a mutual fund or non-redeemable investment fund) with net assets of at least \$5,000,000 as of the date of its most recent financial statements; a person or company recognized by the OSC as an accredited investor; mutual funds or non-redeemable investment funds that distribute securities under a prospectus for which a receipt has been issued; a managed account if it is acquiring a security that is not a security of a mutual fund or non-redeemable investment fund; an account fully managed by a trust company registered under the *Loan and Trust Corporations Act* (Ontario); foreign entities analogous to certain other entities prescribed as accredited investors; and a person or company in respect of which all of the owners (whether direct or indirect, legal or beneficial) are accredited investors.

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.

Shortened Hold Periods

The OSC has also released the final form of Multilateral Instrument 45-102 which will in many circumstances significantly shorten resale restrictions applicable to prospectus-exempt offerings (“hold periods”). Unlike new Rule 45-501 described above, which will change the private placement exemptions only in Ontario, the Multilateral Instrument 45-102 will have the additional benefit of harmonizing hold periods throughout the country (other than Quebec).

Under the new system the hold periods, which are presently six, twelve or eighteen months long, would be four months for “qualified issuers” and twelve months for other issuers. A “qualified issuer” is essentially a reporting issuer with current public disclosure (specifically a current annual information form) and either a listing on a recognized exchange or a minimum prescribed rating from an approved rating organization. Under the new system, securities issued by a “qualified issuer” on a private placement basis will be subject to a four month hold period provided that the issuer has been a reporting issuer for more than four months and the share certificate issued on the private placement contains a legend describing the hold period. The one year seasoning period for securities issued prior to an issuer’s IPO has been retained under the new instrument with an important exception. Securities issued to employees, executive officers, directors and consultants prior to an issuer’s IPO will be subject to a reduced four month seasoning hold period following the IPO under the new instrument.

Provided the new instrument is accepted by the Minister, the new hold periods will apply to resales of securities issued on an exempt basis prior to November 30, 2001. This means that, in some cases, securities privately placed before November 30, 2001 and subject to a hold period that runs beyond November 30, 2001 may qualify for an immediate reduction of the hold period when the new instrument is implemented.

The Multilateral Instrument will also harmonize and simplify the rules concerning distributions by members of a “control block”. The popular “advance notice” exemption, which permits members of a control

block to distribute securities on a prospectus-exempt basis provided that at least seven and not more than fourteen days' advance notice of the proposed trade is given, will continue, but the period of time that the securities must have been held in order for a control block member to rely on the exemption will be shortened to four months (in the case of securities of a qualifying issuer) and twelve months (in all other cases). In addition, the "tainting" provisions for control block holders have been eliminated under the new private placement rules. Once the new instrument is implemented, an acquisition of additional securities of an issuer by a control block holder will not impose a hold period on the entire block of securities of that issuer held by the control block holder. Essentially, the new rules provide control block holders with significantly more flexibility in dealing with their securities.

Impact

The new private placement exemptions will significantly modernize and simplify the private placement regulatory framework in Ontario. The new exemptions will also create significant congruity between Ontario's private placement rules and analogous U.S. requirements. Nevertheless, it is important to note that the new private placement exemptions are unique to Ontario, and that the existing private placement exemption frameworks in the various other provinces and territories will continue to apply, unchanged.

Conversely, the reformulation of the closed system will not only simplify the system but will have the additional benefit of harmonizing the hold period regime across the country (other than in Quebec).

We encourage you to contact us if you would like to discuss the new rules.

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