

securities and public markets bulletin

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Capital Pool Companies in Ontario - Regulatory Overview

Introduction

As conventional initial public offerings (“**IPO**”) face significant difficulties in the current financial climate, more companies may turn to alternative ways of going public in Canada such as the capital pool companies program (the “**CPC Program**”). Originally designed to assist junior companies to access capital markets at earlier stages of their development, the CPC Program enables a “shell” company (i.e., a capital pool company or “**CPC**”) with no assets (other than cash) and no commercial operations go public and obtain a listing on the TSX Venture Exchange (the “**Exchange**”). Following the listing, the CPC has up to 24 months to identify and evaluate suitable assets or businesses which, when acquired, qualify the CPC for a regular listing on the Exchange. This article provides an overview of the main Exchange requirements respecting the CPC Program.

Background

A predecessor to the current CPC Program was initiated in Alberta in 1986. British Columbia and Manitoba also had similar junior capital programs in place. The current CPC Program was created following the merger of the Vancouver Stock Exchange and the Alberta Stock Exchange in 1999. Effective June 15, 2002, the Ontario Securities Commission (the “**OSC**”) by its adoption of OSC Policy 41-601 Capital Pool Companies (“**Policy 41-601**”) extended the CPC Program to Ontario.

In conjunction with the adoption of Policy 41-601, the OSC entered into a CPC Operating Agreement (the “**CPC Operating Agreement**”) with the British Columbia Securities Commission, the Alberta Securities Commission, the Saskatchewan Securities Commission and the Manitoba Securities Commission (the “**CPC Jurisdictions**”) and the Exchange. The Nova Scotia Securities Commission entered into the CPC Operating Agreement in March 2005. The CPC Operating Agreement sets out the procedures to be adopted by parties wishing to utilize the CPC Program.

OSC Policy 41-601 Capital Pool Companies

Policy 41-601 establishes that the OSC will permit CPCs to conduct public offerings in Ontario and that generally a CPC will receive a receipt for its prospectus on the basis of the issuer’s participation in the CPC Program. The OSC, however, will consider issuing a cease trade order in respect of the securities of a CPC if such CPC is delisted, it fails to complete its Qualifying Transaction (as defined below) or otherwise fails to comply with the rules of the CPC Program. Participants in the CPC Program must still comply with applicable securities laws, including National Instrument 41-101 General Prospectus Requirements (“**NI 41-101**”). CPCs are exempt from certain financial statements’ requirements set out in NI 41-101. In addition,

the OSC may consider, on application, exempting a CPC from other provisions of NI 41-101, in whole or in part, subject to such conditions or restrictions as may be imposed in the exemption.

CPC Operating Agreement

The CPC Operating Agreement sets out the standards that the Exchange applies in the review of CPC prospectuses (“**CPC Prospectus**”) and CPC filing statements (“**CPC Filing Statement**”) and CPC information circulars (“**CPC Information Circular**”) prepared in connection with a Qualifying Transaction. Generally, the CPC Jurisdictions rely on the analysis and review carried out by the Exchange in accordance with the CPC Operating Agreement. The principal regulator as per the National Policy 11-202 Process for Prospectus Reviews in Multiple Jurisdictions (“**NP 11-202**”) is responsible for reviewing and issuing the receipt for the preliminary CPC Prospectus, the final CPC Prospectus or any amendment to either pursuant to NI 11-202.

The CPC Operating Agreement further sets out the responsibilities of the Exchange in reviewing CPC disclosure documents, and procedures with regard to pre-filings and waivers of securities legislation in connection with a CPC Prospectus, CPC Filing Statement or CPC Information Circular.

The CPC Program

The CPC Program is currently governed by Exchange Policy 2.4 Capital Pool Companies (“**Policy 2.4**”) and administered under the CPC Operating Agreement. The CPC Program involves a two-stage process:

- the filing and clearing of a CPC prospectus (to be prepared in accordance with applicable securities laws and pursuant to CPC Prospectus Form 3A), the completion of the IPO and the listing of the CPC’s common shares on the Exchange; and reaching an

“agreement in principle”¹ (“Agreement in Principle”) regarding a proposed “qualifying transaction”² (“Qualifying Transaction”) and the preparation and filing with the Exchange of a CPC Filing Statement (Form 3B2) or CPC Information Circular (Form 3B1), as applicable, along with required supporting documents.

Generally, a CPC must file a CPC Information Circular where the proposed Qualifying Transaction is a “non-arm’s length” transaction (as defined in Policy 2.4) or a shareholder approval of the proposed transaction is otherwise required by law. If the proposed Qualifying Transaction is a non-arm’s length Qualifying Transaction or is subject to Exchange Policy 5.9 Insider Bids, Issuer Bids, Business Combinations and Related Party Transactions, “majority of the minority approval” (as defined in Policy 2.4) will be required by the Exchange. Where a shareholder approval is not required, the CPC Filing Statement serves as the disclosure document.

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- 1 “Agreement in Principle” means any enforceable agreement or any other agreement or similar commitment which identifies the fundamental terms upon which the parties agree or intend to agree which:
 - (a) identifies assets or a business to be acquired which would reasonably appear to constitute “significant assets” and the acquisition of which would reasonably appear to constitute a Qualifying Transaction;
 - (b) identifies the parties to the Qualifying Transaction;
 - (c) identifies the consideration to be paid for the “significant assets” or otherwise identifies the means by which the consideration will be determined; and
 - (d) identifies the conditions to any further formal agreements to complete the transaction.

in respect of which there are no material conditions to closing (other than receipt of shareholder approval and Exchange acceptance), the satisfaction of which is dependent upon third parties and beyond the reasonable control of the non-arm’s length parties to the CPC or the non-arm’s length parties to the Qualifying Transaction.

- 2 “Qualifying Transaction” means a transaction where a CPC acquires “significant assets”, other than cash, by way of purchase, amalgamation, merger or arrangement with another company or by other means. “Significant Assets” means one or more assets or businesses which, when purchased, optioned or otherwise acquired by the CPC, together with any other concurrent transactions would result in the CPC meeting the minimum listing requirements as prescribed by Exchange Policy 2.1 Minimum Listing Requirements.

The CPC Program is not available to issuers where prior to the completion of the IPO, an Agreement in Principle has been reached with respect to a proposed Qualifying Transaction. Where there is an agreement in principle, the issuer is required to prepare a regular prospectus.

The Exchange may permit the combination of certain CPCs and certain transactions between a CPC and an existing public company in connection with the completion of the Qualifying Transaction, subject to certain conditions.

Stage 1 – CPC Prospectus and Exchange Listing

Overview of Process

- An issuer wishing to participate in the CPC Program must file via SEDAR a preliminary prospectus and all supporting documentation with the Exchange and with the CPC Jurisdictions in which the distribution will be made. If the IPO is conducted in more than one jurisdiction, the CPC Prospectus should be filed with the regional office of the Exchange corresponding to the principal regulator pursuant to NP 11-202. A CPC must also make an application to the Exchange for conditional acceptance of the listing of the CPC.
 - A CPC must retain an agent who will sign the CPC Prospectus as underwriter. Policy 2.4 sets out rules pertaining to agent's compensation.
 - The Exchange will issue comments in regard to the preliminary CPC Prospectus and the application for listing. Once the application for listing is conditionally accepted, and the relevant Commission(s) indicates that it is clear to receive final materials, the CPC will file its final CPC Prospectus and all supporting documents with the Exchange and the Commission(s).
 - Once a receipt is issued for a final CPC Prospectus and all final listing documentation is filed, the Exchange issues an Exchange bulletin evidencing its final acceptance of the documents, and the shares of the CPC commence trading on Tier 2 of the Exchange.
- All securities of the CPC which fall under the definition of "escrow shares" in Policy 2.4 must be held in escrow pursuant to the CPC escrow agreement.
 - All communications between the Exchange and the CPC that relate to the CPC Prospectus must be made via SEDAR.

Minimum Listing Requirements for CPCs

The following minimum listing requirements must be satisfied to be listed as a CPC with the Exchange and to maintain that listing:

- The CPC and each of its proposed directors and officers must meet the requirements of the Exchange Policy 3.1 - *Directors, Officers and Corporate Governance*. In addition, each director and senior officer of the CPC must either be a resident of Canada or the United States, or an individual who has demonstrated a positive association as a director or officer with one or more public companies that is subject to a regulatory regime comparable to that of a Canadian exchange.
- The Exchange also requires that directors and senior officers of the CPC must collectively possess the appropriate experience, qualifications and history which demonstrates that the management of the CPC will be capable of identifying, investigating and acquiring Significant Assets. Policy 2.4 sets out criteria against which the Exchange will consider the acceptability of each director and senior officer and the board as a whole.
- The minimum price per share at which "seed shares" (i.e., shares issued before the CPC's IPO) may be issued is the greater of \$0.05 and 50% of the price at which the shares offered to the public pursuant to the IPO ("**IPO Shares**") are sold.
- The minimum total amount of seed capital raised by the CPC through the issuance of seed shares must be equal to or greater than \$100,000 and must be contributed by directors and officers of the CPC or trust or holding companies controlled by these directors or officers. Each director and officer of the

CPC or their respective trust (or holding company) must subscribe for seed shares for an aggregate consideration of at least \$5,000. Seed Share subscriptions by others will only be permitted after an initial \$100,000 is contributed by directors and officers.

- The amount of seed capital issued at less than the IPO price can be no greater than \$500,000.
- The minimum price at which the IPO Shares may be issued is \$0.10. Only a single class of common shares may be issued as seed shares and IPO Shares.
- All seed shares' owners must be disclosed to the Exchange. At the time of listing and until completion of the Qualifying Transaction, neither the CPC nor any other party on behalf of the CPC is permitted to engage the services of any person to provide investor relations activities, promotional or market-making services.
- The gross proceeds to the treasury of the CPC from its IPO must be equal to or greater than \$200,000 and must not exceed \$1,900,000.
- The maximum aggregate gross proceeds to the treasury of the CPC from the assurance of IPO Shares and all seed shares and shares issued pursuant to a private placement as permitted under Policy 2.4 must not exceed \$2,000,000.
- The CPC must have at least 1,000,000 of its issued and outstanding common shares in the "public float" (as defined in Exchange Policy 1.1 – *Interpretation*) upon completion of the IPO.
- Upon completion of the IPO, the CPC must have a minimum of 200 shareholders with each shareholder beneficially owning at least 1,000 common shares free of resale restrictions exclusive of any common shares held by non-arm's length parties to the CPC.
- The maximum number of common shares that may be directly or indirectly purchased by any one purchaser pursuant to the IPO is 2% of the IPO Shares. The maximum number of common shares that may be purchased by any purchaser together with that purchaser's associates and affiliates is 4% of the IPO Shares.

- Other than the IPO Shares, securities that may be issued and outstanding must comply with Policy 2.4 and include: seed shares, stock options as permitted by Policy 2.4, the agent's option, any securities issued upon consent of the Exchange in accordance with Policy 2.4, and any securities issued pursuant to the Qualifying Transaction.
- The ownership of seed shares, IPO Shares and shares issued pursuant to a private placement by the sponsor and its associates or affiliates and by any member of the "pro group" (i.e., sponsor, agent, or their directors, officers, employees, contractors, associates or affiliates) must also be in compliance with Policy 2.4.

Restrictions on Business of a CPC

The only business permitted to be undertaken by a CPC pending the completion of the Qualifying Transaction is the identification and evaluation of assets or business with a view to completing a Qualifying Transaction. Policy 2.4 imposes certain limits on use of proceeds raised by the CPC through its IPO and prohibits specific types of payments.

Stage 2 – Completion of a Qualifying Transaction

- The second stage is triggered when there is an Agreement in Principle to acquire Significant Assets that form the basis of the CPC's Qualifying Transaction.
- As soon as a CPC reaches an Agreement in Principle it must issue a comprehensive news release prepared pursuant to Policy 2.4 and file a material change report pursuant to applicable securities laws.
- Prior to issuing the news release, the CPC must send a copy of the draft news release to the Exchange for review.
- Trading in the shares of the CPC will be halted pending the announcement of the Agreement in Principle. Trading generally remains halted until reinstated by the Exchange.
- The CPC has 75 days from the announcement of the Agreement in Principle to submit the draft CPC Information Circular or draft CPC Filing Statement (as

applicable), and if there is a sponsor, the preliminary sponsor report accompanied by a confirmation that the sponsor has reviewed the draft CPC Information Circular or draft CPC Filing Statement (as applicable) on a preliminary due diligence basis. The CPC is also required to file certain other initial submission documentation as prescribed by Policy 2.4. The CPC must prepare and file, along with a CPC Information Circular, proxy materials and related information where a shareholder approval is required for the Qualifying Transaction.

- The Exchange reviews the draft CPC Information Circular or draft CPC Filing Statement (as applicable) and the supporting documents and advises of any comments. Provided that the comments in the initial Exchange comment letter are not of a substantial nature, where shareholder approval is required, the Exchange will permit the CPC to set the date for the shareholder meeting for approval of the proposed Qualifying Transaction.
- Once the CPC application is conditionally accepted, the CPC will be advised to file the pre-meeting/pre-closing documentation pursuant to Policy 2.4 with the Exchange and mail the CPC Information Circular to the shareholders if necessary.
- Once the shareholder approval is obtained, the CPC may close the Qualifying Transaction. Where no shareholder approval is required, the CPC may close the Qualifying Transaction after filing the CPC Filing Statement on SEDAR.
- Once the Qualifying Transaction is closed and the CPC has filed with the Exchange all necessary post-meeting/post-closing documents, the resulting issuer will no longer be considered a CPC and will commence trading under a new name and a new symbol, if applicable.

Exchange Temporary Relief Measures and CPC Program

On November 3, 2008, the Exchange issued a bulletin advising listed issuers that it would consider granting

temporary relief from certain policy requirements on a case by case basis in order to assist listed issuers who, due to current difficult market environment, were facing “conditions of immediate or imminent financial hardship”.

Effective November 3, 2008, any currently listed and trading CPC required to complete a Qualifying Transaction on a date which falls between November 3, 2008 and March 31, 2009 may apply to the Exchange to extend the completion date by an additional six (6) months. In addition, any currently listed and trading CPC contemplating completing a combination with another CPC during the period until March 31, 2009 may apply to the Exchange to extend the date on which it must complete its Qualifying Transaction to the later of: (i) 12 months from the closing date of the combination, and (ii) 24 months from the date of listing of the most recently listed CPC which is a party to the combination.

Conclusion

The CPC Program is designed as a listing and finance vehicle to facilitate raising funds in the junior capital markets for start-up capital. This capital would be available to an issuer at an earlier stage than might otherwise be available to an issuer under the IPO process. According to the Exchange, the CPC Program has proven to be an attractive option for raising capital by emerging companies. Considering relatively low capital thresholds and significant time period allowed for completion of a Qualifying Transaction, the CPC Program may continue to be an attractive financing vehicle for many companies even during the current market down cycle.

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A Cautionary Note

The foregoing provides only an overview. Readers are cautioned against making any decisions based on this material alone. Rather, a qualified lawyer should be consulted.

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About McMillan LLP's Securities and Public Markets Group

Our Securities and Public Markets Group acts for a variety of clients (domestic and foreign issuers of debt and equity securities, municipal, territorial and provincial governments, financial institutions, investment banks and securities dealers) and have extensive experience in all areas of public market securities law practice. Our experience includes corporate finance, mergers and acquisitions, public company servicing, capital markets and registration, and securities litigation.

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