

## **PUBLIC MARKETS BULLETIN**

*September 2005*

### **PREPARING FOR NATIONAL INSTRUMENT 45-106 – PROSPECTUS AND REGISTRATION EXEMPTIONS**

The private placement regime in Canada is set to become more user-friendly on September 14, 2005, when National Instrument 45-106 *Prospectus and Registration Exemptions* (in this bulletin, referred to as “NI 45-106” or the “Instrument”) is expected to come into force, subject to all necessary approvals.

The purpose of the Instrument is to harmonize a number of prospectus and registration exemptions across Canada. The Instrument should assist issuers effecting a multi-jurisdictional exempt distribution to reduce transaction costs, by consolidating the most frequently used exemptions in one instrument in a consistent and concise manner.

While the Instrument is intended to provide issuers with “one stop shopping” for prospectus and registration exemptions, some jurisdictions, including Ontario, have maintained local exemptions and in certain cases have opted out or modified some of the exemptions found in the Instrument.

This bulletin describes those amendments that impact on many of the most commonly used registration and prospectus exemptions in Ontario. For additional details concerning the impact of the Instrument in the Province of Quebec, please see our bulletin entitled “New Opportunities in Quebec’s Financial Markets”.

### **FREQUENTLY USED EXEMPTIONS**

*Accredited Investor Exemption.* All Canadian jurisdictions will adopt the accredited investor exemption found in NI 45-106, which permits trades in securities if the purchaser purchases the security as principal and is an accredited investor. The definition of an accredited investor has elements from both the current Ontario Securities Commission Rule 45-501 *Exempt Distributions* (“Rule 45-501”) and Multilateral Instrument 45-103 *Capital Raising Exemptions* (which is generally in force in Canada except in Ontario and Quebec).

Some changes to the definition of an accredited investor as it currently stands in Ontario include the fact that the exemption available to certain entities with net assets of at least \$5 million will not be available if the entity is created or used solely to purchase or hold securities as an accredited investor. In addition, two new categories of accredited investor include: (i) an investment fund that is advised by a person registered as an adviser (or who is exempt from registration), and (ii) a person acting on behalf of a fully managed account managed by that person, if that person is registered or authorized to carry on business as an adviser or the equivalent under the securities legislation of a jurisdiction of Canada or a foreign jurisdiction and, in Ontario, is purchasing a security *that is not a security of an investment fund*.

The carve-out in Ontario of investment funds from the “fully managed account” branch of the definition is the subject of further study by staff of the Ontario Securities Commission.

*Minimum Amount Exemption.* The minimum amount exemption that was historically available in Ontario was removed in 2001 in favour of the accredited investor exemption. The exemption is being re-introduced into Ontario and will be harmonized across Canada, such that there will be an exemption from the registration and prospectus requirements for trades in a security to a person purchasing securities as principal if the acquisition cost is not less than \$150,000, paid in cash at the time of the trade, and the trade is in a security of a single issuer.

The exemption is less flexible than the exemption that previously existed in Ontario, as it requires the purchase price to be paid in cash, and the former exemption permitted securities to be issued for a future obligation (such as a promissory note). The exemption will not be available for trades in a security to a person if that person is created or used solely to purchase or hold securities in reliance on the exemption.

*Private Issuer Exemption.* Another new (but old) exemption to be available in Ontario will be the private issuer exemption, which will replace the current closely-held issuer exemption. The exemption will permit trades in a security of a “private issuer” to a person who purchases the security as principal and who is a person listed in specified categories, which include:

- directors, officers, employees, founders or control persons of the issuer;
- certain family members, close personal friends and close business associates of a director, executive officer, founder or control person of the issuer;
- a security holder of the issuer;
- an accredited investor; or
- a person that is not a member of the public.

In general, a private issuer is an issuer (i) that is not a reporting issuer or an investment fund, (ii) whose securities (other than non-convertible debt securities) are subject to restrictions on transfer in the constating documents or security holders’ agreements, and which are beneficially owned by not more than 50 persons (excluding employees and former employees of the issuer or its affiliates), and (iii) that has distributed securities only to specified persons, including those persons listed above.

No commission or finder’s fee may be paid to any director, officer, founder or control person of an issuer in connection with this exemption (except for sales to an accredited investor).

Once the Instrument comes into force, a closely-held issuer in Ontario will only be able to use the private issuer exemption if it qualifies as a private issuer, including the limitations on the category of persons who may be security holders. As a result, not all closely-held issuers will be able to rely on the private issuer exemption. A transitional provision will assist with respect to the resale of securities that have been previously acquired in Ontario pursuant to the closely-held issuer exemption.

*Founders, Control Persons and Family.* Ontario will not be adopting the so-called “friends and family exemption”, which in all other jurisdictions will permit certain close personal friends and close business associates of a director, executive officer, or control person of the issuer or an affiliate of the issuer, among others, to purchase securities of an issuer as principal. However, Ontario will adopt a separate exemption for trades in securities to “founders” of the issuer, affiliates of founders, control persons and spouses, parents, siblings, grandparents or children of founders, directors and executive officers, based on an exemption which currently exists.

A “founder” is a person who alone or together with others takes the initiative in founding, organizing or substantially reorganizing the business of the issuer, and who at the time of the trade is actively involved in the business of the issuer.

*Offering Memorandum Exemption.* Another exemption Ontario will not be adopting is the offering memorandum exemption, which provides an exemption if the issuer delivers an offering memorandum to the purchaser buying securities as principal in prescribed form and obtains a signed risk acknowledgement statement in prescribed form. In British Columbia, New Brunswick, Nova Scotia and Newfoundland, sales can be made on the basis of this exemption with no minimum acquisition cost and without involving a registered dealer in the trade. In Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Quebec and Saskatchewan, sales can only be made on the basis of this exemption to (i) “eligible investors” (as defined in the Instrument), or (ii) if the acquisition cost to the purchaser does not exceed \$10,000.

In Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Quebec and Saskatchewan, certain investment funds will be prohibited from relying on the offering memorandum exemption. Only those investment funds which are (a) non-redeemable investment funds, or (b) mutual funds that are (i) reporting issuers, and (ii) in Manitoba, Quebec and Saskatchewan, listed for trading on an exchange or quoted on an over-the-counter market, will be permitted to rely on the exemption.

In New Brunswick, the Northwest Territories, Nunavut and Saskatchewan, no commission or finder’s fee may be paid to any person, other than a registered dealer, in connection with a trade to a purchaser based on the offering memorandum exemption.

*Trades to Employees.* The Instrument generally replicates the exemptions for trades to employees, senior officers, directors and consultants currently contained in Multilateral Instrument 45-105 *Trades to Employees, Senior Officers, Directors and Consultants* (“MI 45-105”). MI 45-105 is expected to be revoked once the Instrument comes into force.

*Business Combinations and Reorganizations.* The exemptions available for trades in a security in connection with amalgamations, mergers, reorganization or arrangements (under a statutory procedure or described in an information circular and approved by security holders), dissolution and winding-up will be combined into one exemption. The intention of the Canadian Securities Administrators is to provide an exemption for all trades needed to complete the transaction, regardless of the period of time required. With respect to exchangeable share transactions, trades may take place years after the transaction has been completed, and such trades are intended to be covered by the exemption.

*Petroleum, Natural Gas or Mining Properties.* The existing Ontario exemption will be expanded to provide an exemption for trades by an issuer in a security of its own issue as consideration for the acquisition of petroleum, natural gas or mining properties or any interest in them. The exemption will be much broader than the current exemption, which only covers mining claims and is only available if the vendor enters into an escrow or pooling arrangement or where the issued securities are listed on a recognized stock exchange.

*Short Term Debt.* An exemption will also be available for negotiable promissory notes or commercial paper, maturing not more than one year from the date of issue, provided that the debt is not convertible into a different type of security, and has an approved credit rating. The requirement that individuals purchase a minimum of \$50,000 has been dropped from the Ontario exemption, but the requirement to have an approved credit rating is new, and may affect the ability of a number of issuers to rely on the exemption.

*Investment Fund Reinvestments:* This exemption is similar to the existing exemptions relating to reinvestment plans, and will permit trades to existing security holders under a plan, if the dividend or distributions out of earnings, surplus, capital or other sources are applied to the purchase of additional securities of the same class or series to which the dividend or distribution was attributable and specified disclosure is made to security holders.

*Additional Investments in Investment Funds:* This exemption harmonizes similar exemptions in many jurisdictions and will permit trades by an investment fund in a security of its own issue to a security holder of the issuer, if (i) the security holder has initially purchased securities as principal at a cost of not less than \$150,000, (ii) the security holder paid in cash at the time of the trade, (iii) the subsequent trade is for a security of the same class or series as the initial trade, and (iv) the security holder at the time of the subsequent trade holds securities of the fund that have an acquisition cost of not less than \$150,000, or a net asset value of not less than \$150,000.

### **PRIVATE PLACEMENT REPORTING**

The new form of trade report required to be filed in connection with the use of many of the prospectus exemptions under the Instrument will be Form 45-106F1. The form will now require disclosure of additional information about the issuer (such as reporting issuer status and disclosure of industry) as well as the total dollar value of the distribution in all jurisdictions (including foreign jurisdictions).

In Ontario, an “Authorization of Indirect Collection of Personal Information for Distributions in Ontario” must be signed by the issuer and filed with the Ontario Securities Commission. In order to provide the requisite information, the issuer must obtain specific authorizations from the purchaser. Even though the information must be collected, the name of the purchaser, residential address and telephone number of the purchaser will not be placed on the public file.

In addition, the filing requirement will only apply to the *issuer* of the securities being traded. As a result, persons who resell securities on the basis of a private placement exemption will no longer be required to file a report, as is currently the case in Ontario.

If a distribution is made in reliance on specified exemptions, including the accredited investor exemption, the private issuer exemption, the founder, control person and family exemption as well as the minimum amount exemption, and an offering memorandum is delivered to a prospective purchaser, the offering memorandum must describe the statutory rights of action that the purchaser may exercise against the issuer in the event that the offering memorandum contains a misrepresentation. Issuers distributing securities on the basis of the accredited investor exemption are not required to provide certain purchasers, such as Canadian financial institutions, with the rights of action. If an offering memorandum is provided to a prospective purchaser, the seller of the securities must deliver a copy (or any amendment) to the Ontario Securities Commission within 10 days of the distribution.

### **ONTARIO’S LOCAL EXEMPTION RULE**

In Ontario, many local exemptions will be consolidated into one rule, the amended and restated Ontario Securities Commission Rule 45-501 *Ontario Prospectus and Registration Exemptions* (the “New Rule 45-501”).

A number of exemptions will be removed from Rule 45-501 and incorporated into the Instrument. Exemptions remaining in New Rule 45-501 will include those for government incentive securities, certain trades in commodity futures options and commodity futures contracts, securities of a co-operative, membership shares of a credit union and trades for self-directed RRSPs.

As a final note, Ontario's "universal registration" system is preserved, requiring all market intermediaries (persons who engage in or hold themselves out as engaging in the business of trading in securities) to register as a dealer in the appropriate category. The Ontario Securities Commission takes the position that if an issuer retains an employee whose primary job is to solicit the public to sell the issuer's securities, both the employer and the employee are market intermediaries.

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*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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