

RAISING MONEY FOR ONTARIO PRIVATE COMPANIES: PRIVATE PLACEMENTS AFTER SEPTEMBER 14TH, 2005

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New Rules In Place

Securities regulators in Ontario overhauled the landscape **as of September 14th, 2005** in order to standardize private placement rules across Canada.¹ Securities regulators in the provinces and territories should be applauded by owner managers for working together to simplify, streamline and standardize the interaction of consumer and market protection legislation with the realities of small and private business financing. After all, Canadian owner managers have been increasingly envious of their American competitors' access to private capital, where the tax and single securities regulator environment was far more supportive of owner managers than in Canada.

These revised exemptions are important, especially when it comes to saving costs. After all, as with all private placement exemptions:

- A prospectus is not required;
- A trade does not have to take place through a registered dealer; and
- Post-trade filing requirements range from none to minimal.

There are a number of changes from the most recent amendments. Some of the limitations on monies raised or numbers of times an exemption can be used have been eliminated, and at least one historical exemption that had been eliminated in Ontario has returned. Rather than tracking all those changes, this article simply summarizes the key provisions as of September 14th, 2005 from an owner manager's perspective. Consider it a fresh start.

Overall, these changes greatly simplify the exemptions available to owners of private Ontario companies, and are a definite improvement over the two most recent Ontario regimes.

¹ National Instrument 45-106 Prospectus and Registration Exemptions.

Who You Are Selling To

The first and longest set of exemptions depends on who you are selling to. The key is to not sell securities to the “public”. While that term is not defined, the rule of thumb is that you can sell securities to various company insiders and their family members, or to high net worth individuals, under one of the following exemptions. The central concept appears to be that these categories of people should have access to the information or resources to “know better” (either through a personal relationship with you or because their net worth grants access good advisors) and therefore do not need to be protected through the use of a prospectus or a licensed intermediary.

Founder, Control Person and Family Exemption²

Your company can sell securities to (A) a founder or an affiliate of a founder; (B) a spouse, parent, brother, sister, grandparent or child of an executive officer, director or founder; or (C) a person in control of your company.

Founder, executive officer, director and control person are all defined terms, and have fairly obvious meanings.

No risk acknowledgement form is required, and no post-trade report is required.

Current Employee, Executive Officer, Director and Consultant Exemption, Including Their Spouses³

Your company can sell securities to (A) its current employees, executive officers, directors or consultants; (B) the current employees, executive officers, directors or consultants of a related entity; or (C) the permitted assign of such a person.

In this context “permitted assign” means (A) a spouse of the person; (B) a trustee, custodian or administrator acting on behalf of such a person or their spouse; (C) a holding entity of the person or their spouse; or (D) an RRSP or RRIF of the person or their spouse.

However, the trade must be voluntary. In other words, it cannot be a required component of their relationship with your company.

No risk acknowledgement form is required, and no post-trade report is required.

Trades between these classes of person are also exempted transactions.⁴

² Section 2.7.

³ Section 2.24.

⁴ Section 2.27.

The “Accredited Investor” Exemption⁵

The accredited investor exemption continues, but without some of the previous limitations and restrictions.

“Accredited investor” has a lengthy definition including twenty-three principal categories. For most owner-managers, the key persons included in this definition are: (A) an individual whose net income alone is in excess of \$200,000.00 per year before taxes, or in excess of \$300,000.00 per year when combined with their spouse; (B) individuals who alone or with their spouse directly or indirectly beneficially own financial assets with a net aggregate realizable value before taxes of \$1,000,000.00; (C) an individual who alone or with their spouse has net assets of all kinds of at least \$5,000,000.00; (D) a company, family trust or other business entity other than an investment fund which has net assets of at least \$5,000,000.00; and (E) a company or business entity where all of its direct or indirect beneficial owners are accredited investors.

No risk acknowledgement form is required, but a post-trade report is necessary⁶.

The “Private Issuer” Exemption⁷

At first glance, the “private issuer” exemption appears to relate to the nature of the company selling the securities. However, upon closer reading, the key to the exemption is, once again, the identity of the person acquiring the securities.

A “private issuer” will be a privately owned Ontario company: (A) whose share transfers require director or shareholder approval as set out in the company’s articles, (B) has no more than 50 shareholders who are not employees or former employees, and (C) has not sold shares to anyone other than certain persons.

In that regard, the list of acceptable shareholders to make use of this exemption is limited to: (A) directors, officers, employees, founders or control persons; (B) the spouses, close family members (a defined list) and close personal friends (not defined) and close business associates (not defined) of a director, executive officer, founder or control person; (C) accredited investors; (D) a holding company or trust controlled by one of the above persons; (E) a trust or estate where all the beneficiaries and the majority of trustees meet the criteria listed above; and (F) a person that is not the public (not defined).

No commission or finder’s fee may be paid to any director, officer, founder or control person in connection with the trade, other than a trade to an accredited investor.

No risk acknowledgement form is required, and no notice of the trade needs to be filed.

⁵ Section 2.3.

⁶ Sections 6.1 and 6.3.

⁷ Section 2.4.

The Affiliates Exemption⁸

Your company may sell securities to an affiliate of the company, provided the affiliate is purchasing as principal.

In this context, “affiliate” means where one company is the subsidiary of another, or the same person controls them.

No risk acknowledgement form is required, and no post-trade report is required.

What You Are Selling

The next group of prospectus, registered dealer and post-trade filing exemptions which interest most owner-managers relate to what you are selling, instead of who you are selling it to.

Minimum Amount Exemption (\$150,000.00 Minimum)⁹

Your company can sell securities (A) to a person who purchases as principal; (B) where the purchase price for the securities is at least \$150,000.00 and is paid in certified funds at the time of the trade; and (C) the transaction is for securities in only one company.

This exemption is not available if the purchaser is created solely to purchase the securities.

A risk acknowledgement is not required, but a post-trade report is necessary.

Minimum Asset Acquisition Exemption (\$150,000.00 Minimum)¹⁰

Your company can issue securities to a person in payment for assets purchased from that person, if the assets purchased have a fair value of not less than \$150,000.00.

No risk acknowledgement is required, but a post-trade report is necessary.

Other Exemptions

There are a number of other exemptions detailed in National Instrument 45-106, but they are of limited interest to owner managers looking to raise money, and are more important to their professional advisors. For example, they deal with transactions that are not intended to be caught by a securities trading regime, such as mergers and amalgamations, corporate re-organizations, short-term notes, syndicated mortgages and PPSA instruments. Since this article is meant to be an overview for Ontario owner managers, and not their professional advisors, I will not review them here.

⁸ Section 2.8.

⁹ Section 2.10.

¹⁰ Section 2.12.

Post-Trade Reports

Several exemptions require post-trade reports with the Ontario Securities Commission.¹¹ For example, the accredited investor, minimum amount and asset acquisition exemptions all require post-trade reports as of September 14th, 2005. However, this list can change over time, so the current legislation should be consulted when a transaction is being contemplated.

The form of report initially implemented in National Instrument 45-106 was ‘Report of Exempt Distribution Form 45-106F1’¹², and had to be filed with the Ontario Securities Commission. As well as identifying the parties, the form required the following information: (A) industry type; (B) description of security, amount paid and date of transaction; (C) exemptions relied upon; (D) details of fees or commissions paid; and (E) authorizations to collect personal information.

When reports are filed, filing fees must also be paid to the Ontario Securities Commission.

As in everything with securities law, the process for gathering the information and approvals for the post-trade filing report, completing the report, and assembling and providing the appropriate fee, is technical and tedious. It needs to be planned in advance as part of the transaction, budgeted and allowed for in terms of time and money, and should only be done with the assistance of professional advisors.

Some Important Warnings

This article is a brief overview of the state of the law in Ontario, as it existed as of September 14th, 2005. Any owner manager reviewing this article needs to keep some important things in mind. In no particular order:

Advertising. National Instrument 45-106 does not prohibit or regulate how you go about finding investors or offering to sell your securities. However, you must keep in mind that these exemptions are meant for companies that are not offering to sell their securities to the public. Since “public” is not defined you must seek professional guidance in your efforts to find investors. For example, if you want to advertise in the mass media, and you are relying on the accredited investor exemption, your advertisement should make it very clear that only accredited investors need respond. If you are relying on the close personal friends or close business associates exemptions, finding such people through advertising is evidence in and of itself that you lacked the necessary relationship to sell securities to them.

Get proper professional advice. This is not an area where owner managers should be designing and implementing their own investment program. Any owner manager seeking to raise investment capital should do their own research, but should work closely with competent professional advisors including lawyers, accountants, bankers and other investment professionals

¹¹ Section 6.1.

¹² Section 6.3.

to design and implement a program that will not only have the best chance of success, but will keep them out of trouble with securities regulators.

No two deals are the same. Just because you did it before, or someone you know has done it, it is not necessarily current, right or appropriate for you or your situation.

Laws change. While the concepts set out in this article were current as at September 14th, 2005, laws change and are re-interpreted. This article may be out of date by the time you read it.

There are penalties for not complying with the Securities Act. These include criminal charges and sanctions, fines and penalties, and bans on trading in securities.

This is not a legal opinion. Although this article was written by lawyers, it is not a legal opinion and should not be relied upon as anything other than a generic explanation of the basic principles involved. A legal opinion applicable to your specific situation should be obtained before you implement any particular investment program.

These issues are jurisdiction dependant. This article was written for business people in Ontario, Canada only, and will have no application to outside that province.