OSC POLICY 41-601
CAPITAL POOL COMPANIES

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INTRODUCTION

The Canadian Venture Exchange Inc. ("CDNX") currently operates a capital pool company program (the "Program") in each of Alberta, Saskatchewan, Manitoba and British Columbia. The Program was designed as a corporate finance vehicle to provide businesses with an opportunity to obtain financing earlier in their development than might otherwise be possible through a normal initial public offering (an "IPO"). The Program permits an IPO to be conducted and a CDNX listing to be achieved by a newly created capital pool company (a "CPC") which has no assets, other than cash, and which has not commenced commercial operations. The CPC then uses this pool of funds to identify and evaluate assets or businesses which, when acquired (a "Qualifying Transaction"), qualify the resulting issuer (the "Resulting Issuer") for listing as a regular Tier 1 or Tier 2 issuer on CDNX.

This Policy sets out the views of the Commission as to whether issuers participating in the Program should be permitted to conduct public offerings in Ontario.

BACKGROUND

In 1986 the Junior Capital Pool ("JCP") program, a predecessor to the Program, was initiated in Alberta through the co-operation of the Alberta Securities Commission and The Alberta Stock Exchange. In 1997, the British Columbia Securities Commission and the Vancouver Stock Exchange adopted a similar program, the Venture Capital Pool ("VCP") program, for use in British Columbia. The current Program, created following the merger of the Vancouver Stock Exchange and The Alberta Stock Exchange in November 1999, replaced the existing VCP and JCP programs. Prior to the merger of the Winnipeg Stock Exchange with CDNX in November 2000 and the subsequent approval of the Program by the Manitoba Securities Commission, a similar junior capital program, known as the Keystone Company program, was previously available in Manitoba.

Staff of the Commission, the Alberta Securities Commission, the British Columbia Securities Commission, the Manitoba Securities Commission and the Saskatchewan Securities Commission have worked together with CDNX to develop a revised version of the Program to operate in each of their respective jurisdictions (collectively, the "CPC Jurisdictions"). Such an initiative will, among other things, assist in harmonizing the ability of entrepreneurs to raise venture capital in the CPC Jurisdictions.

OPERATION OF THE PROGRAM

The Program is currently governed by CDNX Policy 2.4 Capital Pool Companies ("CDNX Policy 2.4"). CDNX Policy 2.4 provides that an issuer wishing to participate in the Program must file a preliminary prospectus and related supporting documents with CDNX as well as with each of the securities regulatory authorities in whose jurisdictions the proposed distribution will be made. A CPC prospectus that is filed in Ontario will be reviewed by the staff of both CDNX and the Commission. Upon the issuance of a receipt for a final prospectus and the completion of its IPO, securities of a CPC will trade on Tier 2 of CDNX. A CPC will have 18 months following its IPO in which to identify and complete a Qualifying Transaction. However, as soon as a CPC reaches an "agreement in principle" (as defined below) with respect to a proposed Qualifying Transaction, it must issue a comprehensive news release. The Program requires each CPC to seek the approval of both CDNX and a majority of its minority shareholders prior to completing the Qualifying Transaction. In connection with obtaining such shareholder approval, the CPC must prepare a comprehensive information circular containing full, true and plain disclosure concerning the CPC and the Target Company. The information circular will be reviewed by CDNX before it is mailed to shareholders of the CPC.

As CDNX has incorporated the disclosure requirements of Commission Rule 41-501 General Prospectus Requirements ("Rule 41-501") into CDNX Policy 2.4 and the related information circular form, the information circular must contain the same information as a company would be required to disclose if it filed a prospectus.

The Program will not be available to issuers if, prior to the completion of its IPO, an agreement in principle has been reached with respect to a proposed Qualifying Transaction. An "agreement in principle" includes 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:

- identifies assets or a business to be acquired which would reasonably appear to constitute "significant assets", the acquisition of which would reasonably appear to constitute a Qualifying Transaction;
- identifies the parties to the Qualifying Transaction;
- identifies the consideration to be paid for the "significant assets" or otherwise identifies the means by which the consideration will be determined; and
- identifies the conditions to any further formal agreements to complete the transaction, and

in respect of which there are no material conditions to closing (other than receipt of shareholder approval and CDNX 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. Both CDNX and the securities regulatory authorities in the CPC Jurisdictions are of the view that if the issuer has reached an agreement in principle, it is able to, and should, prepare a regular prospectus.

Further information regarding the operation of the Program can be found by consulting the CDNX Corporate Finance Manual and CDNX Policy 2.4.

HISTORICAL CONCERNS VERSUS ANTICIPATED BENEFITS OF THE PROGRAM

Historically, the Director has been reluctant to issue a receipt for a prospectus where the prospectus revealed the issuer to have neither a business nor operations and no assets, other than cash. In *Re Loki Resources Inc.* (1984), 7 OSCB 583 the Director noted that where an issuer has neither assets to appraise nor business activities to evaluate, nor any present expectation of either assets or activities, meaningful information regarding an issuer cannot be provided to market participants. Accordingly, in such an instance, the benefits of 'reporting issuer status', including the ability of its securities to freely trade in the market following the expiry of any applicable hold period, should not be conferred upon the issuer. This approach was supported by the subsequent Commission decision in *Re Inland National Capital Inc.* (1996), 19 OSCB 2053.

While the concerns expressed in *Loki* and *Inland National Capital* remain relevant today, the Commission is aware that the implementation of the Program in Ontario may also confer benefits upon Ontario's capital markets by providing entrepreneurs and emerging businesses access to the financial and other resources necessary for such enterprises to fully develop. Moreover, the Commission has also noted that the Program provides certain investor protection provisions that were unavailable in the *Loki* and *Inland National Capital* cases, which, in the view of the Commission, help mitigate the potential for harm to investors identified in those decisions. These provisions include the following:

- management of a CPC is scrutinized by CDNX to ensure that management has experience appropriate to the running of a public company and the completion of a Qualifying Transaction; management's track record must also be disclosed in the CPC prospectus to allow potential investors a basis upon which to make an investment decision;

- the risk of the investment is clearly and prominently disclosed throughout the CPC prospectus;
- directors and officers of a CPC must contribute a minimum amount of cash prior to an IPO, and a CPC may raise only a limited amount of cash under the CPC prospectus; furthermore, a CPC is subject to strict regulation of private placements prior to the completion of its Qualifying Transaction;
- the amount that may be invested by any one individual during an IPO is limited to 2% of the shares issued under the CPC prospectus, and no more than 4% of the shares issued under the CPC prospectus may be purchased by an investor and his or her associates and affiliates during the IPO;
- most shares held by non-arm's length parties of a CPC are escrowed until the completion of the Qualifying Transaction and then are released in stages;
- when a CPC reaches an "agreement in principle" to acquire the business or assets that will be the subject of the Qualifying Transaction, trading in its shares is halted until a detailed press release describing the transaction is issued, a sponsor is retained (unless waived) and CDNX staff is satisfied that there are not obvious reasons why the Qualifying Transaction cannot be completed;
- each CPC must file and distribute to its shareholders an information circular which is subject to review and which must provide prospectus level disclosure of the Qualifying Transaction and the Resulting Issuer in accordance with CDNX requirements (which incorporate the Commission's prospectus requirements as set out in Rule 41-501);
- CDNX staff will closely monitor secondary trading in securities of CPCs to help guard against insider trading; and
- a CPC which fails to complete its Qualifying Transaction within 18 months may be suspended or de-listed and potentially subject to a cease trade order, thereby ensuring that secondary trading in shares of the CPC does not continue indefinitely.

In discharging its statutory duty, the Commission must have consideration for the purposes of the *Securities Act* (the "Act"). Section 1.1 of the Act states that the purposes of the Act are (a) to provide protection to investors from unfair, improper or fraudulent practice, and (b) to foster fair and efficient capital markets and confidence in capital markets. Section 2.1 of the Act provides that, in pursuing the purposes of the Act, the Commission shall have regard to certain fundamental principles, including the following:

- Balancing the importance to be given to each of the purposes of this Act may be required in specific cases.
- The Commission should, subject to an appropriate system of supervision, use the enforcement capability and regulatory expertise of recognized self-regulatory organizations.
- The integration of capital markets is supported and promoted by the sound and responsible harmonization and co-ordination of securities regulation regimes.
- Business and regulatory costs and other restrictions on the business and investment activities of market participants should be proportionate to the significance of the regulatory objectives sought to be realized.

Upon considering the Program and balancing the purposes and principles underlying the Act, the Commission has decided that it would not be prejudicial to the public interest to permit the operation of the Program in Ontario.

AVAILABILITY OF CDNX PROGRAM IN ONTARIO

As the Commission has determined that it would not be prejudicial to the public interest to permit CPCs to conduct initial public offerings in Ontario, the Director is generally willing to issue a final receipt for a CPC's prospectus on the basis of the issuer's participation in the Program.

On the basis of the *Loki and Inland National Capital* cases, however, it is unlikely that, in the absence of an issuer's participation in the Program, the Director will consider it to be in the public interest to issue such a receipt to a 'shell issuer'. Issuers contemplating participation in the Program should therefore be cautioned that the Director will consider issuing a cease trade order in respect of the securities of a CPC if such CPC is de-listed on account of its failure to complete its Qualifying Transaction or otherwise comply with the Program.

FUTURE REVIEW OF THE PROGRAM

Five years after the adoption of the Program in Ontario, the Commission intends to review the functioning of the Program to assess the benefits it confers upon Ontario's capital markets. In unusual circumstances, the Commission may decide to review the operation of the Program at an earlier date.

CONTINUING COMPLIANCE WITH ONTARIO SECURITIES LEGISLATION

Program participants are reminded of their obligations to comply with Ontario securities legislation, including, without limitation, Commission Rule 41-501. In certain circumstances, the CPC's negotiations regarding its Qualifying Transaction may have progressed to the stage where the CPC has a "significant probable acquisition" (as defined in Rule 41-501) but not an "agreement in principle". In this situation, where compliance with Parts 6 and 7 of Rule 41-501 will require a CPC to include in a CPC prospectus financial statements relating to one or more proposed acquisitions, the Director will be prepared to consider, upon application, exempting the CPC from such requirement as the requirement may be inappropriate in the context of the Program.