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BY COURIER

October 18, 2000

Ontario Securities Commission
20 Queen Street West
Suite 1800
Toronto, Ontario M5H 3S8

Attention: Mr. John Stevenson, Secretary

Canadian Securities Administrators
c/o Saskatchewan Securities Commission
920 Broad Street
Suite 800
Regina, Saskatchewan S4P 3V7

Attention: Mr. Dean Murrison, Committee Chair

Dear Mr. Stevenson and Mr. Murrison:

Re: Proposed Rule and Companion Policy 45-501, 45-502 and 72-101

These are my personal comments (and not those of the firm) with respect to Proposed Rule and Companion Policy 45-501 (collectively, the "Private Placement Rule"), with respect to Proposed Multilateral Instrument and Companion Policy 45-102 (collectively, the "Resale Rule") and with respect to proposed Multilateral Instrument and Companion Policy 72-101 (collectively, the "Connecting Factors Rule"). A Word 97 diskette containing the contents of this letter is enclosed.

The Private Placement Rule

(a) **General**

In general, I support broadening access to financing. However, I am very concerned that the Private Placement Rule would, by repealing the private company and $150,000 exemptions, seriously hamper small business financing, unduly complicate the lives of numerous small businesses that do not rely on material external non-bank financing, and compel them to seek additional legal advice (at material cost) for little or no benefit, as well as requiring public disclosure and fees in connection with previously exempt legitimate private corporate structuring activities. It also appears inconsistent in some respects with the U.S. approach, which is inappropriate in our rapidly globalizing capital markets. In the U.S., section 4 of the Securities Act of 1933 (the "1933 Act") provides that the prospectus (actually, the registration statement) requirements of section 5 of the 1933 Act do not apply to "transactions by an issuer not involving any public offering". Thus, private companies appear to be unrestricted in the U.S.

In addition, I am concerned that the proposals are very complex.

For many years, businesspeople in Ontario and across Canada have incorporated private companies with a minimum of fuss to carry on their business. Non-securities lawyers, paralegals and others have been able to assist them in incorporating and capitalizing their businesses. While on occasions it is unclear as to whether or not the "public" may be involved, with the result that securities law experts need to become involved and, if necessary, other exemptions (such as the $150,000 or seed capital exemptions) are utilized, with their associated filings and fees to securities regulators, this is still a relatively rare occurrence. The Private Placement Rule would change all this, and require extensive legal advice and analysis, on the incorporation of all, even the smallest or most private, of businesses. In my view, this is not appropriate and will unduly hamper both small business and legitimate private corporate structuring activity, to little end. The closely-held exemption is not simple. It would be necessary to review all past financings to determine whether the $3 million aggregate threshold would be satisfied and whether advertising was ever undertaken in the past, and a complex analysis of "common enterprise" concept would need to be undertaken. I strongly recommend that the private company exemption be retained. It is also not being repealed in other provinces, and consistency is highly desirable.

A few examples will indicate the problems that will be created and the costs that will result. A Canadian company wishes to set up a new subsidiary with $5 million in cash to exploit a new business opportunity. For whatever reasons (historical book values, high leverage, recent poor results, etc.), it does not have net assets of $5 million. While this raises no investor protection issues, a discretionary exemption will be required and a fee paid. This will take substantial time, expense and legal assistance. Even if it had net assets of $5 million, a filing and fee would be required.

Two different businesses wish to set up a joint venture as to 50% each with a contribution of $50 million each. A filing and fee will result.

A major company wishes to set up a new company to make a $500 million cash tender offer. A filing and fee will result from the set-up, as well as the offer.

Two banks wish to fund a joint venture which will buy their back office operations, for $2 billion each. Alternatively, they will roll their high-valued assets into the joint venture for shares. Filings and very substantial fees will likely result.

A wealthy entrepreneur wishes to invest $10 million in a private family business through a new company. Both the initial investment and the investment in the family business will require filings and fees and / or exemptions.

A small company wishes to roll all or a portion of its assets with a value exceeding $3 million into a new or existing wholly-owned subsidiary. Either a filing and fee, or an exemption and fees if the company does not have net assets exceeding $5 million, will likely result.

Clearly, the private company exemption should be retained. In any event, all flings and fees on joint ventures, investments in subsidiaries and internal restructurings should be waived without a need to seek discretionary relief.

In addition, the $150,000 exemption has provided for a long time a clear black-letter exemption, and is similar to exemptions in place across Canada. Just as a willingness to expend $150,000 on a single investment is not a perfect proxy for sophistication, neither are the proposed accredited investor income or asset test exemptions. Given that one of the key purposes of this revamping of Rule 45-501 is to broaden small business financing, I strongly recommend that both be available, and thus that the $150,000 exemptions be retained. This will also maintain better national harmony.

(b) **Closely-Held Issuer Exemption**

The closely held issuer exemption suggests that advertising at any time in the past would preclude reliance. At a minimum, this should only apply from the date of implementation forward. Preferably, it should only apply to the trade in question.

The closely-held issuer exemption should also link to 35 shareholders, not 35 securityholders, to avoid a potentially complex analysis of what securities are outstanding, and should not look to beneficial ownership, since that is often very hard or impossible (and invasive) to determine. There is also a peculiar provision that deems joint name registered holdings to equal beneficial ownership.

It also raises other questions. For example, is the $3 million intended to be net or gross of expenses and commissions? How are other currencies treated if exchange rates change over time? Are the 5 holders registered or beneficial? If the purchaser is not purchasing as principal, who must the form be sent to? Also, it should be clarified that the form must be provided at least 4 days before the commitment date, given the "in furtherance of" definition of a "trade", and the promoter condition should be based on the knowledge of the issuer, given the vagueness of the definition of promoter.

As noted above, this should supplement, but not replace, the private company exemption.

(c) **Accredited Investor Exemption**

Once again, while adding an accredited investor exemption would be beneficial, we absolutely should not jettison the clear $150,000 exemption in place today. The $150,000 assets exemption should also be maintained.

The definition of accredited investors should include corporations, partnerships and limited partnerships who invest with a view to effective control or active management, as there are many such entities and they do not qualify as non-redeemable investment funds. In addition, the "net assets" test will not work for many such entities, as they often tend to have the right to "call" on investors' funds for investments. Many vehicles use this model and thus may not have the requisite net assets, although they may have the ability to call on substantial financing at any time.

In addition, all existing entities should be grandfathered. Whether they qualify as non-redeemable investment funds or not, they will have raised money based on such exemptions as the "seed capital" and / or $150,000 exemptions. As in para. (y), they must be able to continue to invest irrespective of whether they meet the net assets test. In addition, para. (y) should acknowledge that owners in other Canadian and foreign jurisdictions will not always be accredited investors, and its beneficial interest test makes it very difficult to apply in practice.

The $5 million net assets test is not appropriate in my view. For one thing, it compares book values of assets with fair values of liabilities. In addition, many entities will be capitalized, whether for tax, commercial, carried interest, executive compensation or other reasons, largely by debt. They would not meet a $5 million net assets test, despite their substantial size. A temporary setback could also pull a company below the $5 million net asset threshold. I would recommend a gross assets or revenues test, as well as a right to call fund, test, of $5 million or so in lieu of a net assets test. I would refer you to the similar $25 million test in OSC Rule 91-504 (OTC Derivatives). However, the thresholds should be less for non-derivative products.

Subsidiaries or affiliates of other accredited investors should also be expressly included.

The $1 million test suggests that value is objective. It is not, of course, and thus it is not clear what one would have to do to determine what net realizable value would be. I assume it is net (solely) of expenses of disposition, and not taxes, etc. Would appraisals be required? If so, this may become expensive to determine. How are other currencies treated if exchange rates change over time? Would RRSPs be included and, if so, pre or post-tax?

The concept of "net income" is unclear for an individual. Net of what? Not living expenses or taxes? How are other currencies treated if exchange rates change over time? Would separated or former spouses be included? Who would determine if the individual's expectations were reasonable? Are capital gains included, and if so pre- or post-tax?

Given this uncertainty, at a minimum, the rule should make these exemptions available if a purchaser represents that it meets the tests, provided that the issuer has no reason to believe that the representations are not correct.

Guidance should also be given as to in what circumstances the Commission will recognize a person as an accredited investor, and we would recommend that this should be broad, to facilitate access by the less than wealthy who nevertheless are informed and wish to participate. In fact, given the statutory rights of action now proposed to be made available, much broader access could be justified in cases involving an offering memorandum to which the statutory rights apply.

(d) **Other**

The definition of exchangeable security and exchange issuer should not require a reporting issuer (which in any event may not exist as a concept in certain jurisdictions).

In s. 2.6, as one may not be aware of defaults, this should in my view be based on a knowledge standard.

In s. 2.12, an exemption from (d) should be provided for issuers with actual or pro forma assets and/or revenues over a specified amount, as it is my understanding that this was an RTO-related avoidance provision, and it has only served to create a need for additional exemptive relief in Ontario that does not apply in other provinces.

As the private company exemption is available to a market intermediary, so should the closely-held issuer exemption be.

As ss. 2.1, 2.3 and 2.4 appear to be available to a selling securityholder, footnote 29 is confusing. Presumably s. 4.1 should apply to trades on behalf of an issuer or selling securityholder. You may wish to clarify this. Also, given that the right is statutory now, is s. 4.2 required? Also, is it really appropriate to extend s. 130.1 to trades to family members by including s. 2.4? And by adding a reference to s. 2.1 and s. 2.4 in s. 4.3, filing requirements apply that would not be expected by practitioners and that will require further analysis of what constitutes an offering memorandum, thus further complicating the closely-held issuer exemption in comparison to the private company exemption today. Also, what real purpose is served by s. 4.3 in any event?

What is the general resale exemption for arrangements and the like (formerly s. 6.6 of Rule 45-501)? It now only seems to apply to convertible and similar securities. In my view, arrangements and the like should be treated like an IPO and no resale restrictions whatsoever should apply except to control block persons, which seems to be the result. However, the absence of commentary creates uncertainty as to whether this change is intended.

Is it proposed to adjust the fees payable? They are not readily related to the services provided by the Commission, which may be beyond the Commission's jurisdiction.

Form 45-501F2 contains certifications of "arm's lengthedness" and good faith that are not apparently required by ss. 2.5(2) or (3) of NI 45-102. They should presumably be deleted.

Form 45-501F3, which is required solely for closely-held issuers, then warns that an investment in a closely-held issuer may not be a good investment irrespective of its prospects for success. This seems unduly negative. It also implies that purchasers should seek assurances that the company intends to go public or merge. The former, of course, could easily potentially amount to illegal representations under s. 38(3), and presumably should not be encouraged while s. 38(3) exists.

In section 2.1 of CP 45-501, can one not pay selling expenses in connection with a distribution to accredited investors at the same time as one was doing a closely-held or family offering? While advertising may be verboten, unless the accredited investor offering was of a separate class of securities, perhaps, the suggested prohibition on expenses seems inappropriate and incorrect.

In section 2.2 of CP 45-501, it is not clear how on the words of s. 2.1 a selling securityholder of an issuer that has raised in aggregate over $3 million can rely on the exemption. It appears that the $3 million threshold could preclude such sales at a later date through no fault of the would-be selling securityholder, which seems inappropriate and will likely cause financing problems.

S. 2.6 of CP 45-501 seems very hard to decipher. I would suggest that its meaning be clarified.

S. 2.3 of CP 45-501 should be moved to the rule, and a bright line test added to define "recently".

The Resale Rule

It is unfortunate that Quebec is not a party to this instrument, as it undercuts a lot of its benefit for Ontario issuers and investors, given the historical linkage between these two provinces. I would encourage the Commission to seek to harmonize a rule with Quebec.

The requirement to legend certificates is inappropriate, both because of the increasing reliance on book-entry or certificateless securities, and because even after the applicable periods have elapsed legending causes problems on resale under TSE and other stock exchange rules. I would also refer you to the June 9, 2000 CDS comment letter to Mr. Purdy Crawford in connection with the OSC's five-year legislative review, in which it is stated that "legending of security certificates is one of the primary barriers to the full dematerialization or immobilization of securities within a book-based depository such as CDS".

The references to "private companies" are confusing, as these terms are proposed to be eliminated in Ontario. This represents a further reason to leave the concepts alone in Ontario as well, as discussed above.

Regarding the definition of "qualifying market", often, while a company might not meet ongoing listing standards, the applicable exchange does not delist or suspend it. I would accordingly suggest that being listed and posted should suffice, without regard to meeting listing maintenance requirements. In addition, for a multi-tiered market such as the TSE (exempt and non-exempt companies) or CDNX, one can drop into another category. Also, query why CDN is not included if junior capital pools are acceptable. In addition, the Paris Bourse (now Euronext, presumably) should be included.

Form 45-102F1 requires certification by an issuer (without a knowledge qualification) of beneficial ownership, which is asking too much.

S. 2.7 compels a filing after a distribution. Is this filing required to have been made in all provinces, or solely in the jurisdiction in which the purchaser is located? If the latter, how can this be required as a constitutional matter in cases where there is no activity or nexus with a province? Similar questions are raised by ss. 2.6 and 2 8. Are fees payable in each jurisdiction in such cases? If so, they should be waived.

The words "if such security was acquired by the lender … in a control distribution" in s. 2.8 are new, and seem to change existing law. If the law is to be changed, it may be appropriate to adopt a more internally consistent and logical approach to pledgees. It would also be useful to confirm that this does not affect in any way reliance on the control block resale and pledgee exemptions exemption contained in NI 62-101 (although Appendices B and C thereto will need to be amended). Interestingly, in NI 62-101, the term "seller" was equated to the term "pledgee". S. 2.8 seems to take an opposite approach. This could cause problems in s. 2.8(2) 5 and s. 2.8(4), where the ability of the creditor to sell would turn on the knowledge of the seller if an insider and filings by the seller. This is inappropriate. Similar comments apply to s. 2.8(3).

S. 2.9(2) should include a concept similar to s. 2.9(1), so that a merger should not restart control block resale restriction periods for control persons either.

Ss. 2.3, 2.4 and 2.11 appear to apply to <u>any</u> trade, not just the first trade. Presumably, this is excessive.

Para. 8 of Form 45-102F3 speaks of sales, whereas Form 23 today speaks of distributions. The latter term is preferred since it is more flexible. In addition, it has always been unclear how one can sell privately without having previously acted "in furtherance of" such a private sale, in which case the exemption available for the "in furtherance of" activity is unclear. It would be useful for the Commissions to clarify that private agreement pre-sale activity is acceptable. Para. 11 calls for a date that may not be easily identifiable (when a creditor decides to sell).

S. 1.3 of CP 45-102 is in my view inappropriate for the reasons discussed below in relation to MI 72-101. S. 1.4(2), in my view, inappropriately alters the existing law.

S. 1.9 of CP 45-102 should be made part of the rule if it is to be included. Also, I would suggest that it imposes an unreasonable limitation on resales by a resident of Canada in foreign securities over foreign markets. How can the seller be expected to find out this information at all? In addition, it may require information to be assembled as of a historical date. It also expresses a view of the law which is by no means certain, namely that a resale by a Canadian over a foreign market is a distribution in Canada.

The Connecting Factors Rule

Once again, it is unfortunate that Quebec is not a party to this instrument, as it undercuts a lot of its benefit for Ontario issuers and investors, given the historical linkage between these two provinces. I would encourage the Commission to seek to harmonize a rule with Quebec.

Apart from that, however, I have some fundamental concerns with MI 72-101. To reiterate, given that the securities legislation of the purchaser's jurisdiction is expressly addressed to protecting the purchaser, and the effects or consequences of the sale occur entirely in the purchaser's jurisdiction, I do not believe that, absent flow-back issues, the securities legislation of the issuer's home jurisdiction should have any application, particularly where it would impose different requirements (and arguably result in the need for a filing and fee in both jurisdictions). While the B.C. and Alberta commissions may take a different view, I do not believe that that view is correct as a matter of law. I am of the view that at a minimum it should not be "extended" to other provinces in this manner.

Note also that, once this approach is adopted, there seems to be no reason why it would not be applied to offerings outside Canada by non-Canadian issuers. This only serves to underline the extra-territoriality embodied in this approach. These offerings are unlikely to be considered with Canadian compliance issues in mind, of course.

If, however, the Commissions plan to proceed with this instrument, then I am of the view that connecting factors that are unrelated to flow-back issues should be deleted. This should result in the deletion of the following factors, in my view: mind and management of the issuer; principal register location (as an administrative matter, this seems entirely irrelevant); and location of principal operations. Connecting factors should be related solely to the presence of the principal trading market and the likelihood of flowback, as in the U.S.

Given the general (albeit far from perfect) harmony of securities laws in Canada, it seems highly unlikely that non-bona fide backdoor underwritings are a major issue, and in any event they can be handled as a compliance / enforcement matter.

I would recommend extending acceptance to French prospectuses, as there have been a number of major offerings / transactions in Canada by issuers from France (e.g. Alcatel, Vivendi, etc.). Also, query why CDN is not included if junior capital pools are acceptable, and the Paris Bourse (now Euronext, presumably) should be included.

S. 2.1(c) should not require a total prohibition. Rather, the provisions should not apply beyond a "come to rest" period of time, say 90 days.

S. 2.1(d) (and s. 2.4(d)) should also specifically exempt normal commercial activities, press releases and compliance with continuous disclosure obligations. SEC Release 5180 may form a useful starting point as to what should be carved out, but it should also be kept in mind that the Internet and national media can carry events beyond the borders of a province. Accordingly, no prospectus marketing activities should result in this provision being triggered. In fact, it may be that provisions such as ss. 2.1(d) and 2.4(d) are simply not workable in the modern world.

S. 2.4(b) should not require a total prohibition. Rather, the provisions should not apply beyond a "come to rest" period of time, say 90 days. S. 2.4(c) seems inappropriate. This is a general issue regarding hold periods, and to apply it solely here seems inappropriate in my view and may in fact suggest that this sort of activity in the face of a hold period is otherwise acceptable.

S. 2.5 requires a report by an issuer relying on the exemption, and then compels a reasonable diligence standard. Any such standard should be embodied in a rule, not a Form. Presumably, fees would be required in certain jurisdictions. These should be waived.

S. 2.6 applies to any trade, not just the first trade. Presumably, this is excessive. If the trade is from a control block, does the language of section 2.6 inadvertently carve it out from being a distribution? S. 2.6 should probably also deal with pledgees of non-control blocks as well, as their situation is unclear where one is relying on the "seller's" knowledge.

S. 3.1(10) of CP 72-101 suggests that a purchaser subject to a hold period can resell outside the local jurisdiction under s. 2.4 of MI 72-101. This requires the issuer to be involved in underwriting arrangements (and not to engage in market preparation activities), which seems inappropriate in cases where the issuer would not be involved.

I hope that these comments are helpful. I am also sending a copy to Mr. Crawford, as they may be of interest to him in the 5 year review process.

Yours truly,

Simon Romano

SAR/he

cc. Purdy Crawford, Chair, 5 Year Review Committee