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BY COURIER

Mr. John Stevenson
Secretary
Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, ON M5H 3S8

Dear Mr. Stevenson:

Re: Proposed Rule 45-501 – Exempt Distributions

This is a submission made in response to the request for comments dated September 8, 2000 issued by the Ontario Securities Commission (the "Commission") regarding the proposed OSC Rule 45-501 – Exempt Distributions (the "Rule"). As requested, a diskette containing an electronic copy of this submission is included with this letter.

I wish to advise the Commission that I am in support of the Rule, and strongly endorse the initiative by the Commission to modernize and enhance the exempt market rules. I am encouraged by the effort to create a more rational basis for exempt financings, and believe that the three new exemption categories will greatly assist in facilitating faster and more cost effective financings for private issuers. More flexible exempt financing rules will facilitate the growth of Ontario's technology-based industries which, in particular, rely heavily on private placement financings for capital during their initial growth phases.

The focus of my comments on the Rule are confined to the information statement included as Form 45-501F3 (the "Form"). I do not wish to comment on the content of the Form, or even the mandatory requirement that it be delivered in the context of utilization of the closely-held issuer exemption. I anticipate that the Commission will receive a number of comments from market participants on the contents of the Form and the implications for the issuer if the Form is not delivered.

Rather my comments to the Commission in respect of the Form are made in the overall context of the corporate governance framework applicable to private issuers. I recognize at the outset that matters of corporate governance would not normally be within the scope of the policy mandate of the Commission. However, I believe that the introduction of the Form may offer an ideal opportunity to introduce concepts of proper corporate governance to small, closely-held private issuers. As is noted in the concluding words of the Form, "greater numbers of public investors are getting in on the ground floor by investing in small businesses". The introduction of the Rule, coupled with the growth of the Internet and other electronic means of market intermediation, provide new opportunities for private companies to access family, friends, "angels" and other private investors who may not have extensive familiarity with matters of corporate finance or corporate governance. At the other end of the scale, the growth of significant pools of capital allocated to private markets by pension funds and other institutional investors has generated increased focus on corporate governance practices in private companies.

The difficulty is that investors in private companies have only limited legal resources at their disposal to exercise influence over corporate governance practices. The Ontario *Business Corporations Act* ("OBCA") and the Canada *Business Corporations Act* ("CBCA") provide certain statutory tools to shareholders in respect of the day-today activities of a company such as (i) the right to approve corporate by-laws (CBCA Section 103(2)); (ii) the right to appoint directors (Section 106 CBCA); (iii) the right to make a shareholder proposal at a shareholder meeting (Section 137 CBCA); (iv) the right to obtain annual financial statements (Section 155 CBCA); and (v) the right to approve (in some cases by class vote) certain fundamental changes affecting the corporation (Section 173 CBCA), together with the right to dissent and be paid fair value for their shares. The common law, as codified in the corporate statutes, also imposes a fiduciary obligation upon directors to act "honestly and in good faith with a view to the best interests of corporation" (Note: but not its individual shareholders).

Where directors of the corporation have taken action that shareholders view as harmful, the corporate statutes provide several types of remedy including (i) and the right to seek judicial relief from "oppressive conduct" (Section 241 CBCA); (iii) the right to commence a derivative action on behalf of the corporation (Section 239 CBCA); and (iv) the right to apply to the court for an order compelling the directors to comply with the corporation's articles, by-laws or governing statute (Section 247 CBCA).

Generally however, if a shareholder wishes to enforce the corporate governance requirements of the corporate statutes or seek relief from oppressive conduct, an application to the courts must be commenced, which can be a cumbersome and financially prohibitive remedy for all but the most determined and well-financed private investor.

For public companies, extensive rules established by the Commission and the various stock exchanges provide investors with multiple layers of protection and oversight in many matters of corporate governance such as issuance of shares, disclosure of material changes, approval of stock option plans, and regulation of take-over bids and related party transactions. In this regard reference is made to the guidelines for improved corporate governance contained in the December 1994 report of the TSE's Committee on Corporate Governance. No such statutory or policy protections exist for investors in private companies, nor do they benefit from the discipline and open disclosure of the public markets.

In many closely-held private companies, a shareholders agreement would typically establish codes of conduct and rules for corporate governance by which all of the shareholders would agree to be bound. Depending upon individual circumstances, the subscription agreement by which the investor acquires shares in a private company may also contain certain corporate governance covenants on the part of the company. However, a shareholders agreement is purely a matter of contract and there is no obligation on the part of the private issuer, its board or its major shareholders to include all shareholders as parties to the shareholders agreement.

In light of the foregoing, I would like to recommend that the investor protection principles which led to the creation of the Form be extended to corporate governance matters. I would recommend that the Form be amended to provide, as a companion document, an optional code of corporate conduct to which private issuers could subscribe if they choose. When an issuer is providing the Form to a potential investor, the issuer can elect to provide, as an additional commitment to each investor, its agreement to abide by a form of model corporate conduct which would be appended to the Form. I have taken the opportunity of drafting a template form of conduct code which is attached to this letter as Schedule "A" and which is based upon the OECD model code of corporate governance and other similar precedents.

I am of the view that adherence to a model code of corporate conduct on a voluntary basis by private issuers will enhance the attractiveness of the issuer's securities in the marketplace, and assist the issuer in establishing credibility with its shareholders. To quote from a recent report prepared by the International Corporate Governance Network:

> "…the governance profile of a corporation is now an essential factor that investors take into consideration when deciding how to allocate their investment capital."

I recognize, of course, that as a voluntary code of conduct, the question of enforcement remains uncertain and, in the absence of any statutory remedy (which I would generally not support), it would be up to the pressures of the market place and the individual company shareholders to

enforce compliance. Adherence to the model code could also be addressed in private contractual arrangements such as representations and warranties and ongoing covenants between the issuer and its shareholders, as could any variations to the code which the issuer deemed appropriate in the circumstances.

In conclusion, I welcome the modernization of the exempt purchaser rules as reflected in the draft Rule, and I would also urge that the Commission consider the downstream consequences of the introduction of the Rule by taking the additional step of establishing a model code of corporate conduct for the on-going protection of exempt market purchasers.

Yours very truly,

Steven J. Trumper

SJT:lj
Encl.- Diskette

SCHEDULE "A"

ONTARIO MODEL CODE OF CORPORATE GOVERNANCE FOR PRIVATE ISSUERS

The Company agrees that it will abide by the rules of corporate governance set out below in the conduct of its business operations and its relationship with its shareholders at all times until it completes an initial public offering of its shares:

1. **Communications and Reporting.** The Company agrees that it will disclose accurate, adequate and timely information to all of its shareholders at the same time so as to allow investors to be aware of all material events concerning the issuer, and to make informed decisions about the acquisition, ownership obligations and rights and sale of shares.

2. **Board of Directors.** The Company will disclose to its shareholders upon appointment to the Board and thereafter on an annual basis, the identities, core competencies, professional or other backgrounds, factors affecting independence and overall qualifications of Board members and nominees so as to enable investors to weigh the value they add to the Company. The Company shall endeavour at all times to have at least one independent member with an appropriate competency on the Board of Directors. The Board will be involved in all major decisions affecting the Company.

3. **Business Plan.** The Company will not make major strategic modifications to its core business without the prior approval of shareholders to the proposed modification.

4. **Corporate Remuneration Policies.** The Company will disclose annually to its shareholders the remuneration breakdown of individual Board members and top executives.

5. **Equal Treatment.** The Company will treat all shareholders equally in a fair and impartial manner proportionate to their respective interests in the Company, and will ensure that the rights of all investors, including minority and foreign shareholders, are protected.

6. **Related Party Transactions.** Any material transaction involving the Company and a significant shareholder will be submitted to shareholders for approval.

7. **Stock Options.** All plans that provide for the distribution of stock or stock options to employees and/or directors will be submitted to shareholders for approval.

8. **Corporate Finance.** The Company shall use reasonable efforts to ensure that:

(a) if an opportunity arises for shareholders to sell their securities in the Company; or

(b) an opportunity arises to subscribe for additional securities issued by the Company (excluding incentive securities and securities issued to strategic investors);

such opportunity will be made available to, and allocated equitably and proportionately among, all of its shareholders.