December 14, 2000

DELIVERED

Ontario Securities Commission
20 Queen Street West
Suite 1900, Box 55
Toronto, ON M5H 3S8

Attention: Mr. John Stevenson, Secretary

Dear Sirs/Mesdames:

Proposed OSC Rule 45-501 - Exempt Distributions (the "Rule")

This comment letter is being provided in response to the Request for Comments found at (2000) 23 OSCB 6205. As requested, a diskette containing an electronic copy of this submission is included with this letter. Section references in this letter refer to specific Sections in the Rule.

We support the proposed amendments to the Rule, and the introduction of the accredited investor, closely-held issuer and family member exemptions, and encourage the Ontario Securities Commission (the "Commission") to finalize the amendments expeditiously. Our comments which follow are generally of a technical nature.

1. **Proposed Addition to the Companion Policy**. We recommend inserting a section in the Companion Policy which clarifies that the time at which any test set forth in the Rule (i.e., to be an "accredited investor" or a "family member") is satisfied is at the time of the investment and is not a continuing test during the life of the investment.

2. **Section 1.1(m) and Section 1.1(n). – Definition of "accredited investor".** Although we understand the position articulated on this point by the Commission, we continue to be of the view that the test for an accredited investor should be amended to include the net equity (i.e., the unencumbered value) of such person's real estate assets. We believe that many wealthy individuals will have invested a significant portion of their assets in real estate having a value far in excess of what would be necessary to meet their minimum housing needs. In our view, those individuals should be no less entitled to the benefit of the accredited investor exemption than those individuals who have chosen to live in more austere accommodations and invest a larger component of their net worth in other types of assets. Further, certain accredited investors may have acquired real estate assets other than principal residences, and these should be assets available for the calculation of net

worth. Accordingly, we see no policy reason for excluding the unencumbered value of real estate, whether in the form of principal residence or otherwise, in the calculation.

We also recommend that Section 3.1 of Companion Policy 45-501 CP (the "Policy") be amended to eliminate the requirement for a "statutory declaration". This is an anachronistic, paper-based requirement which will require the investor to swear the declaration in front of a lawyer or commissioner of oaths. A representation from the investor, as contemplated by the Section, is sufficient for the purposes of the Rule and Policy. Further, the Policy should expressly permit the representation to be given electronically, for example, by clicking a spot on a website.

3. **Section 1.1(s) - Definition of "accredited investor".** With respect to the concept of the investment company or other entity, it is uncertain whether the list contained in subsection (s) would include all potential types of investment vehicles that are active in the venture capital market, particularly U.S. and European investment vehicles. As such, in order to allow flexibility for future investment structures, we would recommend that, after the words "or estate", the words "or other similar investment vehicles" be added to anticipate future variations on investment vehicle formats. An alternative would be to amend Subsection 1.1(x) to refer to subsection 1.1(s), although this would be less preferable as it would exclude new Canadian-based variations on investment vehicle forms.

4. **Subsection 1.1 – Definition of "closely-held issuer".** In Subsection (c) of the definition of "closely-held issuer", we recommend that the threshold of 35 persons be increased to 50 persons. There are currently numerous companies in Ontario that have in their articles of incorporation the so-called "private company restrictions" which, in accordance with the current definition of "private company" in the Ontario *Securities Act* (the "Act"), are limited to not more than 50 shareholders, excluding certain employees. Similarly, there may be numerous entities that have arranged their affairs so as to qualify as "private issuers" under the current wording of Rule 45-501. We are concerned that many of these issuers may have more than 35 shareholders (or unitholders) and less than 50. As such, the reduction of the threshold to 35 persons or companies even though additional categories of persons or companies, such as accredited investors and family members, are excluded from the count, may limit the ability of some issuers to raise additional capital.

We therefore respectfully request that staff once again reconsider raising the 35 investor limit to 50. These investors will not be people of substantial means; otherwise they would qualify as accredited investors and not count toward the 35 investor limit. In order for an issuer to raise the maximum of $3 million contemplated from only 35 investors, each would have to contribute an average of $85,714. We submit that this is inconsistent with the policy rationale for allowing non-accredited investors to participate in financing start-up companies, and with the desire to reduce the level of risk to an individual

associated with such an investment to an amount more affordable, and potentially less devastating, than the current $150,000 minimum.

5. **Subsection 2.1(b) – Information Statement.** We are concerned that in the event that the information statement is not provided to the investor at least four days prior to the trade (for example, if it is provided three days prior to the trade, two days prior to the trade or not at all), that the validity of securities issued in reliance on the closely-held issuer exemption may be subsequently called into question. In addition, there may be ambiguity about whether or not the information statement was "provided" to the purchaser. As such, we would suggest that the section be amended to provide that the purchaser may rescind the trade at any time up until the fourth day following the date upon which he or she is provided with the information statement.

6. **Subsection 2.1(d) – Selling Expenses.** In order to clarify what will constitute "selling" expenses, we would recommend that the same words be inserted in Subsection 2.1(b) as have been utilized in Subsection 2.8 – that is "except for expenses relating to administrative or professional services".

7. **Section 2.3 – Accredited Investor.** With respect to the purchase by accredited investors who are "managed accounts" as defined in Subsection 1.1(w) of the definition of "accredited investor", we are assuming that the reference in Subsection 2.3 to "purchasing as principal" means that the purchase by a manager on behalf of a managed account will be considered to be a purchase by the account "as principal". Clearly by definition, a manager of a managed account is not purchasing as principal, but as agent for its clients.

8. **Subsection 2.4(a) – Family Member.** We question why siblings are excluded from the family unit which will be authorized to trade on an exempt basis. If the Commission believes that an officer or director will provide sufficient information to grandparents, parents or children so as to allow them to make an investment decision, there is no reason to think siblings would not also be given such information. Siblings may indeed be in a better position to make such a decision, being of the same generation as the officer or director and therefore likely to be at least as aware of markets, and the sibling's abilities, as a parent, grandparent or child would be.

   The same addition should be made to Subsection 2.4(c) as we suggested for 2.1(d) above – ie. "except for expenses relating to administrative or professional services".

9. **Section 2.8 – Convertible Security.** We would propose that Subsection 2.8 be amended from both a drafting and a substantive perspective as follows:

   (a) Subsections 25 and 53 of the Act do not apply to a trade by an issuer in an underlying security of its own issue to a holder of a convertible security or multiple convertible security of the issuer on:

(i) the exercise by the issuer of its right under the convertible security or multiple convertible security to cause the holder to convert into or purchase the underlying security; or

(ii) the automatic conversion of the convertible security or multiple convertible security; or

(iii) the exercise by the holder of a convertible security or multiple convertible security of the holder's conversion rights;

if, in each case, no commission or remuneration is paid or given to others for the trade except for administrative or professional services or for services performed by a registered dealer."

While we believe that the trades covered in Subsection (a)(iii) are covered in section 72(1)(f)(iii) of the Act, we suggest that including Subsection (a)(iii) here will result in the complete exemption being found in one place.

10. **Part 4 – Offering Memorandum.** Section 4.1 contemplates that the statutory right of action shall apply in respect of an offering memorandum delivered to a proposed purchaser in connection with a trade made in reliance upon the exemptions in section 2.1, 2.3 or 2.4.

Section 4.2 then provides that the exemptions are removed if the statutory right of action is not described in the offering memorandum. We would submit that failure to include a description of the statutory right of action should not be fatal to the legality of the transaction. We would suggest that the importance of inclusion of this description is no longer of significant importance now that the right is statutory, as opposed to the situation when it was a contractual right. Relevant to this point is also the fact that what may or may not be an "offering memorandum" is an open question in many cases. (i.e. Is an internal business plan reviewed for due diligence purposes an offering memorandum? How about a lengthy share subscription agreement with many representations and warranties about an issuer?) We recommend deleting Section 4.2.

Section 4.1(2) of the Companion Policy makes reference to the proposed National Instrument 52-101 regarding the requirements relating to the inclusion of future oriented financial information in an offering memorandum. We would suggest removing the restrictions regarding future oriented financial information in offering memoranda for the following reasons:

- Future oriented financial information is often included in offering memoranda in the United States without these sorts of restrictions. In cross-border offerings, offending FOFI is blacked out of U.S. offering documents so that it is not made available to Ontario investors. We do not believe that it is in the best interests of Ontario investors that they should not have access to the same information as American investors in an offering. This issue also arises for Canadian issuers that

offer into the U.S., as the FOFI information may be included in the documents made available for U.S. investors but not Ontario investors.

- There is an exemption in the FOFI rules that permits investors investing more than Cdn.$500,000 to access FOFI information without audit review, etc. Now that the Commission has decided to move away from the amount being invested as a proxy for investment sophistication in the context of the private placement exemptions, we would suggest that it should be similarly moving away from amount invested as a proxy for sophistication in the context of the FOFI rules. (In other words, FOFI information should be available without regard to how much is invested by accredited investors.)

11. **Section 6.5 – Resale of an Underlying Security of a Multiple Convertible Security, Convertible Security or an Exchangeable Security Acquired under Certain Exemptions**. This section has been modified to clarify that the resale restrictions apply whether the underlying security has been issued or transferred to the security holder. We agree that it is appropriate for underlying securities that are transferred in a trade which constitutes an exempt distribution to be subject to the resale restrictions. We do not think that section 6.5 should apply to securities acquired in a trade which does not itself constitute a distribution. Section 6.5 should apply only to the resale of underlying securities acquired pursuant to an exemption from the prospectus requirement, such as section 2.8 of the Rule or clause 72(1)(f)(iii) of the Act. As drafted, section 6.5 would apply resale restrictions to securities transferred on exchange of an Exchangeable Security even if the exchange is not a distribution, with the result that resale restrictions would become applicable to securities that were previously freely tradeable. We would propose that section 6.5 be revised as follows:

    "A trade in an underlying security acquired under an exemption from the prospectus requirement on conversion or exchange of a multiple convertible security, convertible security or exchangeable security, if the multiple convertible security, convertible security or exchangeable security was acquired in a Type 1 trade, is subject to section 2.5 of MI 45-102."

12. **Information Statement**. We would suggest that the proposed Information Statement should be drafted in a way more appropriate to the variety of persons who will be receiving it. We are concerned that, as currently drafted, some of the more sophisticated non-accredited investors who receive it may find its tone to be somewhat condescending.

In conclusion, we welcome the modernization of the exempt purchaser rules as reflected in the draft Rule, and we would ask the Commission to consider the changes suggested in our letter. If you have any questions or comments, please contact David McIntyre (416-862-6516), Ward Sellers (416-862-4226), Steven Trumper (416-862-6562) or Craig Wright (613-787-1035).

Yours very truly,

OSLER, HOSKIN & HARCOURT LLP

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Encl.