January 10, 2001

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

Attention: John Stevenson, Secretary

Dear Sirs/Mesdames:

Re. Proposed OSC Rule 45-501 – Exempt Distributions

The Canadian Venture Exchange ("CDNX") appreciates the opportunity to comment on Proposed Rule 45-501 (the "Proposed Rule") of the Ontario Securities Commission (the "OSC" or the "Commission"). CDNX operates a venture stock exchange designed for emerging companies, and is particularly interested in matters relating to the access to capital by its listed companies and by emerging companies in general.

We wish to state that we support and commend the efforts of the Commission to improve the effectiveness of Ontario's distribution exemptions and thereby increase investor opportunities and broaden access to capital by issuers, particularly emerging companies.

Our comments are set out below in three sections. First, we have included a brief comment on the harmonization of the exempt distribution regimes between the Canadian provinces. Second, we have included some general comment on the nature of the proposals for Ontario. Finally, we have provided specific comment on the proposed exemptions. By way of introduction, our comments relate to the following:

(a) our concern that Ontario is moving farther from harmonization with the other provinces in respect of the various provincial exempt distribution regimes;

(b) our concern that the range of exempt distribution options should be expanded to provide maximum financing flexibility for issuers and investors, and should not be reduced in the manner contemplated by the Proposed Rule; and

(c) our concern that Ontario's exempt distribution regime is becoming polarized in nature between exemptions with limited investor involvement on the one hand and very restrictive investor qualification standards on the other, and that a middle

ground which more creatively balances the variety of investor safeguards available should be adopted.

A. NATIONAL HARMONIZATION

Though it has become trite to say, the lack of uniformity between the provincial exempt distribution regimes is a very real hindrance to the efficient formation of capital by issuers, particularly at the emerging company level. The differences between the regimes add to the complexity and costs of exempt financing. They also introduce time inefficiencies due to the necessities of dealing with the added regulatory issues presented by multiple jurisdictions.

We support the Commission's decision to revise the Ontario regime at this time rather than postponing such revision in order to pursue harmonization with the exempt distribution regimes of the other provinces. However, we believe harmonization should remain a high priority for the Commission, and should be pursued by the Commission both:

(a) through discussions with other provincial securities regulatory authorities; *and*

(b) through the retention *and implementation* in Ontario of exemptions which parallel those in effective use in other provinces.

On the latter point, though we applaud the introduction in Ontario of new and innovative exemptions such as the closely-held issuer and accredited investor exemptions, we are concerned that by removing current exemptions and by not introducing additional exemptions which in each case parallel exemptions in the other provinces, Ontario is moving farther from inter-provincial harmony.

B. NATURE OF THE PROPOSED EXEMPT REGIME

We support the revision of Ontario's exempt distribution regime, but we are concerned that the proposed exemptions and the manner in which they are being implemented (in particular, the substitution for rather than the supplementing of certain current exemptions) do not provide an exempt distribution regime which is expansive enough to best serve Ontario's capital markets. In particular, we have concerns regarding the proposed removal of current exemptions from the range of options available to issuers and their investors.

We recognize that the design of any specific exemption or the design of the exempt regime generally reflects a balance between facilitating access to capital on the one hand, and safeguarding investor interests on the other. Within this context, however, we submit that the exempt regime should be designed with the goal of providing issuers and

investors with as many financing and investment options as possible, keeping in mind in each case the necessity for adequate investor safeguards.

In this regard, we refer by way of example to the CDNX minimum listing requirements ("MLR"), which provide a wide range of alternative listing standards within a variety of industry categories. Indeed, some commentators who have examined the CDNX MLR at a cursory level have criticized the "first-blush" complexity of the CDNX listing standards. However, our experience has been that once issuers and their advisors understand the range of options that are available, they are overwhelmingly supportive of the flexibility offered by our numerous listing options.

Similarly, we are of the view that Ontario's exempt distribution regime should provide as many options for exempt financing as possible. As with the CDNX MLR, each alternative should represent a different manner of balancing the competing interests at play. In the case of distribution exemptions, such competing interests would be access to capital on the one hand, and investor safeguards on the other. While it is important that the various exemptions do not create confusion through conflict in the application of the exemptions, we do not think that streamlining the number of available exemptions is a helpful or viable way to reduce complexity within the context of the already complicated closed system.

Accordingly, we are of the view that any revisions to the exempt distribution regime should supplement, rather than substitute for, the current exemptions.

$150,000 Exemption

In particular, we are of the view that the $150,000 exemption should be maintained (but suggest that the minimum investment amount should be reduced, as discussed below). While we recognize the Commission's view that the proposed closely held issuer exemption provides a close substitute for the current private company exemption, this is not the case as between the proposed accredited investor exemption and the current $150,000 exemption. The $150,000 exemption applies a different test of investor suitability than the proposed accredited investor exemption, and accordingly provides additional flexibility to the very limited effectiveness of the proposed accredited investor exemption as far as individual investors are concerned (see comments below).

Additionally, the $150,000 exemption has been used extensively in Ontario, is well understood, and has an identical conceptual basis (though it differs in amount) to exemptions available in the western provinces. Though it is not a perfect proxy for investor sophistication, no arbitrary financial test provides such a perfect proxy in any event. Maintaining the $150,000 exemption would provide additional flexibility for issuers and investors. Accordingly, we are of the view that the $150,000 exemption is a useful financing option that should be maintained for use in Ontario alongside the proposed exemptions.

As any investor purchasing securities pursuant to the $150,000 exemption will have met the inherent test of suitability, we believe that, as with the proposed accredited investor exemption, such investors should not be counted towards the numerical investor limit contained in the proposed closely held issuer exemption.

We would also suggest that the OSC reduce the minimum investment amount to $97,000 to promote harmonization with the exemptions available in other Canadian provinces. If a statutory right of action is extended to all offering memoranda voluntarily delivered in connection with an exempt distribution, the combination of a reduced minimum investment amount and added statutory protection would strike a new and useful balance between investor protection and capital raising activity.

Additional Exemptions

With a view to providing issuers and investors with as many financing options as possible *and* moving towards harmonization with the other provinces, we believe the Commission should also expand the current and proposed distribution exemptions by adding exemptions similar to exemptions available in other provinces (British Columbia in particular), as set out below. We note in particular that the exemptions discussed below have found very effective use in bridging the “financing gap” that exists under the current and proposed Ontario exempt distribution regimes for emerging issuers (see comments below under “Balancing Interests and the Missing Middle Ground” and “Closely Held Issuer Exemption”).

BC $25,000 Exemptions

British Columbia has two $25,000 minimum purchase distribution exemptions (the “BC $25,000 Exemptions”) which offer additional approaches to managing the balance between providing access to capital on the one hand and protecting investors on the other. The balance set by the BC $25,000 Exemptions lies in the reduction of the minimum investment amount to $25,000 and a corresponding increase in the disclosure requirement (through the mandatory delivery of an offering memorandum), together with:

(a) in the case of the $25,000 - sophisticated purchaser exemption, investor qualification requirements (through an investor “ability to evaluate” test *and* the application of alternative investor financial tests); and

(b) in the case of the $25,000 – registrant required exemption, the requirement that the purchaser receive the advice of a registrant.

The balance between investor protection and access to capital provided by the BC $25,000 Exemptions is reasonable and provides additional financing flexibility. The alternative net worth and net income tests contained in the $25,000 – sophisticated purchaser exemption are much easier to satisfy than the tests contained in the Commission’s proposed accredited investor exemption, however, investor suitability is

maintained through the application of those tests combined with the “able to evaluate” requirement and, most importantly, the mandatory provision of disclosure through an offering memorandum. In the case of the $25,000 – registrant required exemption, the balance on the investor protection side is maintained by professional advice. As important, in both cases, the paramount nature of investor protection is maintained through the mandatory provision of disclosure by way of an offering memorandum.

The Commission may find the “ability to evaluate” requirement noted above difficult or impractical to apply. In this regard, we would submit that the balance between access to capital and investor protection is adequately served in the case of a minimum $25,000 investment by mandating offering memorandum disclosure, and by applying some form of financial test (such as the alternative net worth or net income tests in the BC $25,000 – sophisticated purchaser exemption, or a relaxed version of the financial tests contained in the Commission’s proposed accredited investor exemption), or by imposing a requirement that a registrant’s advice be provided. We also point out that in the event the Commission proceeds with the implementation of statutory rights of action for misrepresentation in an offering memorandum, investor protection would be even greater in the case of exemptions modeled on the BC $25,000 Exemptions due to the mandatory delivery of an offering memorandum.

As a final note, we understand that provinces other than British Columbia have indicated they are considering adding distribution exemptions similar to the BC $25,000 Exemptions.

Short Form Offering Document Exemption

The short form offering document exemption (the “SFOD Exemption”) currently in use in British Columbia provides another example of an exemption which strikes a unique and innovative balance between investor protection and access to capital. The SFOD Exemption permits investors to participate in a small financing (up to $1,000,000 per year) undertaken by a “SHAIF” issuer (meaning an issuer which maintains a permanent disclosure record), provided that the issuer has completed a short form offering document. The short form offering document is a supplement to the issuer’s annual information form and continuous disclosure documents and, when taken together with such documents, provides the investor with a comprehensive disclosure base for the issuer. Further investor safeguards built into the SFOD Exemption are maximum purchase limits per investor of the lesser of two percent of the offering and $10,000, together with a certificate signed by the agent conducting the offering. What is uniquely attractive to investors about the SFOD Exemption is that shares purchased under the exemption within the prescribed limits are not subject to a hold period.

Balancing Interests and the Missing Middle Ground

All restrictions contained in securities legislation governing the purchase of securities represent a balance between the unimpeded flow of capital on the one hand and investor

safeguards on the other. Securities legislation provides a continuum between the prospectus offering (which imposes no investor qualifications but has disclosure and broker representation requirements) and exempt distributions such as the financial institutions exemption (which imposes no disclosure requirements but mandates strict purchaser qualifications). Various factors – such as the qualifications of the purchaser, the number of purchasers at risk, the size of the investment (or amount of money at risk), and the level of disclosure delivered to investors − are considered in the balancing of these interests. However, two factors which are not widely utilized in the design of distribution exemptions but could be effective in the balancing of these interests are stock exchange listings and broker representation.

The purchase of a listed security has inherent investor safeguards as compared to the purchase of an unlisted security. Listed securities provide the investor with liquidity and with the protection afforded by the stock exchange's issuer regulation. By way of example, an investor purchasing an unlisted limited partnership unit has the benefit of neither the liquidity nor the stock exchange oversight that is present in the case of the purchase of a listed security, yet the current exempt distribution regime treats each purchase in the same manner. Accordingly, a distribution exemption that requires a stock exchange listing should afford the possibility of a reduced minimum purchase amount, as the interests of investor safeguards and access to capital are balanced.

Under numerous distribution exemptions contained in the current regime and under the proposed accredited investor and family member exemptions, an investor who does not meet certain qualifications is precluded from buying a listed security pursuant to an exempt distribution at a permitted stock exchange discount, yet can buy the same security in the market on the same day at the higher market price. The only difference with respect to the open market purchase is that the purchaser has presumably received the advice of a registrant (and, in fact, even this distinction is being eliminated as investing moves to discount and online brokers which offer less advice and impose less rigorous or non-existent suitability requirements). A distribution exemption requiring that the purchaser receive the advice of a registrant would put the investor in the same position (subject to the applicable hold period) at a cheaper price than the open market purchase. A distribution exemption requiring an offering memorandum with statutory rights of action would put the investor in a better position than the open market purchase. The advantage for the issuer, of course, is the faster time to market facilitated by the exempt distribution.

Currently, much of Ontario's exempt distribution regime (actual and proposed) is split between exemptions which limit total investor exposure by capping the number of investors involved (for example, the proposed closely held issuer exemption), and exemptions which limit individual investor exposure by setting investor qualification standards (such as the proposed accredited investor exemption). Unfortunately, the first approach limits investor involvement to the very few in number, and the second approach limits investor involvement to the very few in financial means.

Under these approaches, a "financing gap" will exist in Ontario for emerging companies alternatively faced with strict limitations on investor numbers and prohibitively high qualifications for investor participation. We need in Ontario some middle ground. The introduction in Ontario of additional exemptions based on a mix of exemption design features would assist in closing this gap. Stock exchange listings and registrant advice are useful design tools that the Commission could use to develop such exemptions.

CONTENT OF THE PROPOSED EXEMPTIONS

Closely Held Issuer Exemption

Generally speaking, we are of the view that the proposed closely held issuer exemption is a useful addition to the range of distribution exemptions available to Ontario issuers and investors. However, we believe it should be introduced as an additional financing exemption and not in substitution for current Ontario exemptions and the introduction of exemptions in use in other provinces.

The closely held issuer exemption has clear limitations. When considered in conjunction with the Ontario exempt distribution regime as contemplated by the Proposed Rule, a financing gap is evident for emerging issuers which have exhausted the 35 investor limit. Emerging companies are financed in continuous rounds of financing, and require access to capital at a variety of stages of development and through various levels of financing. In particular, the typical emerging company will not be able to "graduate" to sole reliance on public and accredited investor financing following the investment of a maximum of $3,000,000 and 35 investors. To expect an emerging company to do so, whether it is publicly listed or not, is unrealistic. Emerging companies require additional exempt financing options, or they will fail to secure the capital that they require for successful business growth.

To assist in addressing this financing gap, we would encourage the Commission to change the total investor and investment amount limits to rolling annual limits, recognizing the manner in which emerging companies are typically financed. For example, annual limits of 25 or 50 investors and $1,000,000 would go much farther to helping emerging companies achieve sustainable growth, and would still "cap" the exposure of investors to the enterprise.

Alternatively, should the Commission wish to maintain the closely held issuer exemption in a form which more perfectly substitutes for the current private company exemption, we would encourage the Commission to adopt an additional exemption based on rolling annual limits. The British Columbia 50 purchaser exemption (which permits annual purchases by up to 50 different purchasers where the purchaser is "sophisticated" or related to a senior officer of director of the company and receives an offering memorandum) is an example of an exemption with such a rolling annual limit.

However, the introduction of the closely held issuer exemption in any form, while helpful, will not by itself (or with the proposed accredited investor exemption) provide an exempt distribution regime which adequately serves the varying needs of emerging companies and investors. As discussed above, we believe that Ontario's capital markets would benefit from the introduction of additional exemptions specifically designed to address the financing gap that exists in the current and proposed exempt distribution regimes for emerging companies situated between the pure start-up phase and the senior public market phase. To fully accommodate these companies, Ontario requires a comprehensive set of exemptions developed from the full range and combination of available design features.

Accredited Investor Exemption

The proposed accredited investor exemption represents the introduction to Ontario of a useful concept that has worked well in the United States. It also represents a helpful rationalization of the current 72(1)(a) (financial institution) and (c) (exempt purchaser) exemptions, and does open up the field somewhat to high income and high liquid asset individuals. However, it does not significantly increase investment opportunities for individual Ontario residents, nor does it significantly increase access to capital for issuers, due to the small percentage of Ontario residents that would meet the proposed financial tests.

As a starting point, we believe the proposed accredited investor exemption should be considered as a supplement to and not a substitution for any of the current exemptions. In addition, we are of the view that the investor financial tests should be liberalized to make the exemption a more realistic alternative for Ontario residents. As it stands now, the regime does not accommodate exempt capital raising activity among middle and high-middle income Ontario residents who may be interested in and capable of evaluating a proposed investment.

Family Member Exemption

We suggest that the proposed family member exemption be expanded to include siblings of an issuer's officers, directors and promoters, and close friends and associates of an issuer's senior officers and directors.

With respect to siblings, we believe that substantially the same family connection factors are present in the case of siblings as in the case of, for example, parents. Most officers, directors and promoters of an issuer will, at the time they are involved in the financing of the issuer, be living on their own and apart from parents and grandparents. Similarly, we are of the view that officers, directors and promoters involved in the financing of a business will generally hold the interests of their siblings in the same regard as the interests of their parents and grandparents.

In respect of close friends and business associates, we recognize the Commission's concerns over the difficulty in identifying the line separating such persons from the

"public". We also understand that this concern is reflected in the Commission's desire to remove the private company exemption. For similar reasons, and based on the varying motivations that may be reflected in a promoter's actions, we would not propose extending this exemption to friends and business associates of a promoter. However, we do advocate extending the exemption to close friends and business associates of the company's senior officers and directors.

Our concern in this regard is the reality that for many emerging companies, close friends and business associates are the company's most likely investors, and are in a unique position (based on their personal knowledge of the principals) to make an investment decision. In fact, in many ways, personal knowledge of a director or senior officer gives more valuable and practical information than can be provided in any offering document or by any registrant. To alleviate concerns the Commission may have over extending the exemption to close friends and business associates, the Commission might consider capping the number of close friends and business associates that may purchase securities of an issuer in a given year (as discussed above, we believe that an annual rolling limit is more effective and realistic than a fixed limit).

SUMMARY

In summary, CDNX respectfully submits the following to the Commission:

(a) harmonization of the exempt distribution regimes between provinces should be a high priority for the Commission;

(b) harmonization should be pursued both through discussion with the relevant provincial authorities *and* through the implementation in Ontario of exemptions which parallel those available in other provinces;

(c) Ontario's exempt distribution regime should provide issuers and investors with as much financing and investing flexibility as possible through the provision of a wide range of exemptions;

(d) the $150,000 exemption should be maintained and the minimum investment amount should be reduced to $97,000;

(e) exemptions should be introduced in Ontario modeled on the:

  (i) BC $25,000 Exemptions; and

  (ii) the SFOD Exemption;

(f) exemptions which occupy the middle ground between exemptions with very limited investor involvement on the one hand and very restrictive investor qualification standards on the other should be designed using the full range and

varying combination of investor safeguards, including stock exchange listings and broker involvement, as well as differing minimum purchase amounts, investor sophistication tests and disclosure (offering memorandum and short form offering document) requirements;

(g) the restrictions in the closely-held issuer exemption should be redesigned or a separate distribution exemption should be introduced incorporating annual rolling investor and investment limits, in recognition of the multiple stages in which emerging companies are typically financed;

(h) the accredited investor tests for individual investors are too restrictive to permit participation by a significant number of Ontario residents in distributions carried out pursuant to the proposed form of the exemption; and

(i) the family member exemption should be extended to siblings and expanded to include close friends and business associates of the senior officers and directors of an issuer.

Again, we thank you for this opportunity to comment on the Proposed Rule.

As generally requested of the public by the British Columbia and Alberta Securities Commissions, we are copying them on this comment letter.

Yours very truly,

Kevan Cowan
Vice President, Ontario
Canadian Venture Exchange

cc. British Columbia Securities Commission
Attention: Brenda Benham, Director

Alberta Securities Commission
Attention: Denise F. Hendrickson, Legal Counsel