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BY E-MAIL

Alberta Securities Commission
Manitoba Securities Commission
Securities Administration Branch, New Brunswick
Securities Commission of Newfoundland and Labrador
Registrar of Securities, Department of Justice, Government of the Northwest Territories
Nova Scotia Securities Commission
Registrar of Securities, Legal Registries Division, Department of Justice, Government of Nunavut
Ontario Securities Commission
Office of the Attorney General, Prince Edward Island
Commission des valeurs mobilières du Québec
Saskatchewan Securities Commission
Registrar of Securities, Government of Yukon

Dear Sir/Madam:

Proposed National Instrument 51-102 – Continuous Disclosure Obligations
Request for Comment

We are writing to you in response to the Request for Comment in respect of proposed National Instrument 51-102 – Continuous Disclosure Obligations (the "Proposed Instrument") published in the June 21, 2002 Ontario Securities Commission Bulletin.

In general terms, we support the policy of harmonizing continuous disclosure obligations, making it easier and less costly for issuers that are reporting issuers in more than one Canadian jurisdiction to know and comply with their continuous disclosure obligations. The following sets forth our comments with respect to the Proposed Instrument.

1. **Criteria for Determining Financial Statement Filing Deadlines.**

While it is not clear to us that the current financial reporting deadlines are creating any problems in the marketplace, we generally support the proposed shortening of the deadlines for the filing of annual and interim financial statements and related materials for issuers having the capacity to meet those deadlines without incurring unjustified expense or compromising the quality of those materials.

As a general matter, in setting the test to determine which issuers will be subject to the earlier deadlines, we believe it is important that you consider feedback from issuers and their auditors regarding the difficulties that may be involved in meeting those deadlines. These market participants are best positioned to comment on any practical difficulties or costs that may be encountered as a result of the earlier deadlines.

From our perspective as legal counsel, we have concerns about the appropriateness of using the Toronto Stock Exchange ("TSX") non-exempt issuer status as the test to determine the deadlines for filing financial statements. Whether an issuer is granted non-exempt status is subject to the discretion of the TSX. While one of the purposes of the basic criteria for exemption is to identify small issuers that require additional supervision by the TSX, many issuers that are exempt would not generally be regarded as senior issuers in the marketplace and may encounter difficulties in meeting the earlier deadlines. Further, it is not clear how non-TSX listed issuers would apply the test. Is the requirement that the appropriate criteria for exemption from section 502 be satisfied and, if so, what year is the "fiscal year immediately preceding the filing of the listing application" for this purpose?

We suggest that the test adopted be set out in the Proposed Instrument and be as simple as possible for all issuers to apply. Specifically, we suggest that you consider adopting the market capitalization test for the basic qualification criteria for the use of the short form prospectus system in National Instrument 44-101 as the test. This test has the merit of being familiar and easily applied and would capture a set of issuers that we expect would be more likely to be regarded as senior issuers in the marketplace and that would be less likely to encounter unjustified difficulties in meeting the earlier deadlines. We agree that the market capitalization test (or any test for that matter) will not, in all cases, be an appropriate way to assess a particular issuer's ability to prepare financial disclosure prior to the earlier deadlines without incurring unjustified expense or compromising the quality of those materials. Consequently, we believe that the Proposed Instrument should include a mechanism allowing issuers to obtain relief from the earlier financial reporting deadlines in appropriate circumstances.

2. **Significant Acquisitions Disclosure.**

Significance Thresholds.

We support the policy of requiring disclosure of financial information relating to a significant acquisition on a continuous disclosure basis and not just in connection with an offering of securities of the acquiror.

In answer to the specific question raised in item 6 of the Request for Comment, if the question could be answered in isolation, our view would be that a single threshold for determining significance is preferable as it would:

- simplify an overly complex rule;
- recognize that the thresholds are largely arbitrary; and
- avoid fine distinctions that are not necessarily defensible (for example, the difference between the 20% and 50% thresholds in terms of the significance of an acquisition is defensible, but the difference between the 40% and 50% thresholds and the 40% and 20% thresholds is more difficult to justify).

Having said that, however, the higher priority, in our view, is consistency as to thresholds with both the prospectus rules in Canada and the SEC rules. Accordingly, unless and until those rules are changed, we would support leaving thresholds unchanged.

Audit Reports.

We have concerns about the appropriateness of the requirement of the Proposed Instrument that financial statements of the acquired business be accompanied by an audit report and that the report not contain a reservation (except in the limited circumstances set out in the Proposed Instrument). If a reporting issuer acquires a business in reliance on unaudited statements, or on statements without a clean audit report, its obligation should be to report that fact in its business acquisition report, not to have the statements audited or the reservation removed (if, indeed, that is possible). What may be appropriate to require in the capital raising context (where clean audited statements of the acquired business are the price of admission to the capital markets) is not necessarily appropriate to require in the continuous disclosure context where such requirements might operate as an impediment to the reporting issuer's ability to make an acquisition or to its ability to satisfy its obligations to file a business acquisition report in respect of it. We submit that an issuer should be required to file the historical financial statements on which it relied in connection with the acquisition. It is a matter of the reporting issuer's business judgment whether it ought properly to rely on unaudited statements or on an audit report containing a reservation. We would make a similar observation with respect to requirements of the rule relating to Canadian (or substantially equivalent) GAAS and GAAP standards. Whereas a reporting issuer can fairly be required to reconcile foreign financial statements to Canadian GAAP in order to access the Canadian capital markets, it should be free to base its acquisition decision on whatever financial statements it considers appropriate, and its disclosure obligations should be limited to those statements upon which it actually relied.

Form of Business Acquisition Report.

Item 2.4 of the business acquisition report requires the issuer to "describe any material obligations that must be met to keep any agreement relating to the significant acquisition in good standing". Given that the acquisition transaction will have closed by the time the report is required to be filed, it is unlikely that the acquisition agreement would be required to be kept in good standing. Item 2.4 should be clarified to more clearly describe the nature of the information the item is intended to elicit.

Item 2.6 of the business acquisition report obligates the reporting issuer to describe any valuation opinion obtained by the acquired business or by the reporting issuer within the last 12 months required under securities legislation or a requirement of a Canadian exchange or market. In our view, the requirement is both unnecessary and potentially confusing. If the valuation opinion was *required* to be obtained, its disclosure will be governed by the rule which necessitated its preparation in the first instance (for example, Rule 61-501 would require its disclosure to shareholders in a proxy circular to assist shareholders in deciding how to vote on a transaction). Moreover, a valuation opinion published in a proxy circular is for the information of a limited class, that is, the shareholders entitled to vote on the matter, and not for the market as a whole. At the same time, having the valuation information repeated in a business acquisition report does not provide any additional information to the market as the information will have already been disclosed. The requirement is also potentially a source of confusion since valuation opinions are routinely relied on by acquirors but only those required to be prepared under securities legislation or stock exchange requirements would be disclosed in business acquisition reports. Finally, it strikes us as being beyond the purpose of the report to require the reporting issuer to defend the price paid for the acquired business in this manner, and if that is not the purpose of the disclosure, then it is not clear what other purpose is served. We respectfully submit that item 2.6 be deleted.

3. **Requirement to File Material Documents.**

While we support the requirement for issuers to provide additional disclosure of documents that impact upon and set out the rights of securityholders, we submit that the nature of documents which would require disclosure pursuant to the Proposed Instrument is unclear and would suggest that the Proposed Instrument be more specific in this regard.

The Proposed Instrument refers to any "agreement or other instrument that defines or otherwise materially affects the rights of securityholders or creates a security". We submit that the requirement to file documents that materially affect the rights of securityholders is too broad in its scope and, as drafted, would include documents such as commercial agreements to which an issuer may be a party which provide for the possibility of the creation and/or issuance of a security to another party (for example, the issuance of a debenture which is convertible into shares of an issuer or the entering into of a joint venture or other commercial collaboration pursuant to which a party may have a right to acquire securities of an issuer). At a minimum, the rule or companion policy should clarify that ordinary commercial agreements are not generally required to be filed. The policy should also list, by way of illustration, the types of documents that would generally be regarded as affecting the rights of securityholders in order to give guidance on the interpretation of the phrase.

While we support the requirement for issuers to make publicly available their constating documents, requiring issuers to file the other suggested documents may not be an efficient way of ensuring that the relevant material information is conveyed to securityholders or prospective securityholders of an issuer and may also lead to an unmanageable number of applications for exemption from such filing requirement and/or applications to keep a portion of such documents confidential, due to the sensitive and competitive nature of information often contained in commercial documents. Under existing securities legislation, if any such document or transaction constitutes a "material change", an issuer would be required to describe such document or transaction in a press release and material change report. The objective of the Proposed Instrument can be met by incorporating the material change report in an issuer's AIF, rather than requiring additional disclosure in the AIF. If the document or transaction in question does not constitute a "material change", we submit that it would be more appropriate to require issuers to provide a description of the general nature of the document or transaction in its AIF, in order for existing or prospective securityholders to be made aware of the component of the document or transaction which creates a security or which has a direct, material "effect on the rights of securityholders".

4. **Criteria for Identifying Small Issuers and Approach to Regulation of Small Issuers.**

We agree that, in concept, smaller issuers should, for reasons of lack of economies of scale and such issuers' inability to compete for timely obtaining of finite resources, be subject to different requirements than senior issuers. Specifically, as we have noted earlier, smaller issuers are not likely to have the internal resources or be able to compete with senior issuers for the attention of auditors in order to be able to produce audited annual financial statements within 90 days of their fiscal year-end. However, we again question the adoption of the "non-exempt issuer" criteria from the TSX manual as the appropriate dividing line between senior and junior issuers. The criteria for exemption from Section 502 of the TSX manual are marginally higher than the TSX minimum listing requirements and in fact are quite similar to the minimum listing requirements for a projected profitable company. Therefore, using the TSX non-exempt issuer concept may subject all but the most junior, and likely newly listed, issuers to the shorter filing deadlines. If the pool of non-exempt issuers is that limited, the benefit to issuers in making the distinction will be restricted to a very few.

We submit that it is not necessary to use both the TSX non-exempt issuer concept and the small business concept contained in the Proposed Instrument. We recognize that the small business concept is suggested for purposes other than setting the filing deadlines for financial statements (i.e. in respect of the exemption from the requirement to file an AIF and for the modified significance tests for acquisitions), however, we suggest that a test based on the small business concept which includes some minimum market capitalization test would be appropriate for all purposes under the Proposed Instrument and use of the TSX non-exempt issuer concept could be dispensed with. Using only one test would have the benefit of simplifying the Proposed Instrument and also of eliminating distinctions between the two concepts that may not be necessary. For example, the existing proposed small business definition refers only to assets of an issuer, in contrast to the focus in the TSX definition on the exempt issuer's net tangible assets; as well, the small business definition is based on the revenues of the issuer, while the TSX definition focuses on the earnings. We suggest that the broader tests are those based on assets and revenues and that if such tests were set at an appropriate minimum, they would serve the objectives of the Proposed Instrument at least as well as the TSX tests, especially as the TSX tests were designed for reporting issuers that are listed, while the Proposed

Instrument test would apply to all reporting issuers. We submit that having one test in the Proposed Instrument would avoid the necessity of consequential changes if the TSX were to change its criteria for non-exempt issuers. We are not in a position to suggest that $10,000,000 is the appropriate level of revenues and assets for the small business test, however, we believe that those levels ought to be something more than just an arbitrary number and should be based on a demographic of existing reporting issuers.

We submit that at least two of the objectives of the Proposed Instrument are to ensure quality of disclosure and timeliness of disclosure by reporting issuers. Any issuer with a market value of less than $75 million will be unable to access the alternate short form prospectus rules in National Instrument 44-101. Under National Instrument 41-501, an issuer going to market under a long-form prospectus must include its audited financial statements for its most recently completed financial year that ends more than 90 days prior to the date of the prospectus. Accordingly, allowing more small businesses a longer time to file their financial statements will not result in such small businesses accessing the capital markets without their most recent financial statements on the public record. Conversely, those issuers who desire quick access to the capital markets are usually in a financial position to effect expedited delivery of continuous disclosure material.

With respect to quality of disclosure, the modification of the level of disclosure required of small businesses in the context of a significant acquisition is in our view reasonable and cost justified. We have commented earlier on the appropriateness of requiring audited financial statements and auditors' reports without reservation and would simply reiterate those comments here.

5. **Rescission of National Policy Statement 3.**

The Proposed Instrument would rescind National Policy Statement No. 3 – Unacceptable Auditors ("NPS-3"). Section 3.6 of the Companion Policy to the Proposed Instrument provides that the definition of Canadian GAAS, when read together with the objectivity standard for auditors contained in the Standards of Professional Conduct applicable to Canadian auditors in each jurisdiction, emphasizes the importance of the independence of the auditor. We submit that NPS-3 provided more guidance and clarity with respect to the independence of auditors and would recommend including the full text of NPS-3 or similar language in the Proposed Instrument.

Please do not hesitate to contact Mindy Gilbert (416) 367-6907 to discuss our comments further.

Yours very truly,

(signed) Davies Ward Phillips & Vineberg LLP