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May 1, 2003

Delivered by Email

Alberta Securities Commission
British Columbia Securities Commission
Manitoba Securities Commission
Nova Scotia Securities Commission
Ontario Securities Commission
Prince Edward Island Securities Office
Saskatchewan Securities Commission

c/o Marsha Manolescu
Senior Legal Counsel
Alberta Securities Commission
4th floor, 300 – 5th Avenue S.W.
Calgary, Alberta
T2P 3C4

Dear Sirs/Mesdames:

Re: Request For Comments
Proposed Repeal and Replacement of Multilateral Instrument 45-102 *Resale of Securities* ("Proposed MI 45-102")

I am writing in response to your request for comments in relation to Proposed MI 45-102. As a general comment, I and other members of this firm are very supportive of the simplification of the resale rules. In particular, the elimination of the distinction between qualifying issuers and others, the elimination of the accelerated insider reporting obligations on control block sales, and the simplification of Form 45-102F3 (now to be F1) are all welcome changes. Our specific comments are to suggest ways in which Proposed MI 45-102 could, in our view, be further improved.

1. Clarification of "Unusual Effort"

Like the current resale rule (the "Current Resale Rule") and its legislative predecessors, Proposed MI 45-102 requires that, in order for a resale to be an exempt distribution, "no unusual effort" can be made to prepare the market or to create a demand for the securities that are the subject of the resale. Although this concept has been a part of the legislation since the closed system was adopted, there is very little guidance as to its meaning. Without having undertaken an exhaustive review of the authorities, it appears that the

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only legislative interpretation is in section 4 of the Alberta Securities Commission Rules, which states as follows:

> "4. Unusual effort to prepare market – For the purposes of sections 2.5(2)5., 2.5(3)., 2.6(3)3., 2.6(4)3., 2.8(3)2. of Multilateral Instrument 45-102 *Resale of Securities*, an unusual effort to prepare the market or to create a demand for securities takes place if 1 or more of the following activities is engaged in by or on behalf of the vendor of the securities:
>
> (a) the dissemination to prospective purchasers of material soliciting orders to purchase, unless the material consists only of a letter or communication
>
> (i) identifying the securities being sold, and
>
> (ii) advising that they are available,
>
> and that letter or communication may comprise or be accompanied by 1 or more of the following:
>
> (iii) an annual report;
>
> (iv) an interim report;
>
> (v) an information circular;
>
> (vi) a take-over bid circular;
>
> (vii) an issuer bid circular;
>
> (viii) a prospectus;
>
> (ix) an offering memorandum;
>
> (x) a document or documents not referred to in sub clause (iii) to (ix) prepared pursuant to a statute or a regulation primarily for some other purpose;
>
> (b) the formation of a selling group or any similar arrangement to co-ordinate the efforts of more than 1 registrant to effect the sale;
>
> (c) the implementation of any transaction or sequence of transactions, plan or other arrangement to manipulate or adjust the market price of the securities, other than price stabilization activities

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(i) reasonably necessary for the maintenance of an orderly market, and

(ii) not going beyond what is accepted on the market where those activities occur;

(d) any sales effort that

(i) is illegal or improper by the standards of the market in which it is made, or

(ii) involves the communication of false or misleading information;

(e) the making of a sale to a purchaser with whom the vendor is not dealing at arm's length in order to put the purchaser in a position where the purchaser may re-sell the securities free of constraints to which the vendor was subject;

(f) in the case of sales made as described in section 2.8(1) of Multilateral Instrument 45-102 *Resale of Securities* where there is a market for the securities, the making of a sale other than

(i) a sale made

(A) in the market in which securities of the particular class are customarily traded, and

(B) in a manner customary in that market, or

(ii) a sale made pursuant to section 131(1) of the Act."

In Ontario, there is no comparable provision. The ruling in *Re Daon Developments Corp.* (1984) OSCB 3428 is very similar to the Alberta provision and is often relied upon as indicating the view in Ontario. The ruling provided for the following definition of "unusual effort":

> "an 'unusual effort to prepare the market or to create a demand for securities' takes place if one or more of the following activities is engaged in by or on behalf of the vendor of the securities:
>
> (i) the dissemination to prospective purchasers of material soliciting orders to purchase, unless the material consists only of a letter or communication

identifying the securities being sold and advising that they are available, which letter or communication may comprise, or be accompanied by either or both of:

(A) a document or documents prepared pursuant to statute or regulation primarily for some other purpose, such as an annual report, an interim report, an information circular, a take-over bid circular, an issuer bid circular or a prospectus, or

(B) an offering memorandum under which a contractual right of action is available;

(ii) the formation of a selling group or any similar arrangement to co-ordinate the efforts of more than one registrant to effect the sale;

(iii) the implementation of any transaction or sequence of transactions, plan or other arrangement to manipulate or adjust the market price of the securities, but price stabilization activities reasonably necessary for the maintenance of an orderly market and not going beyond what is accepted on the market where the activities occur shall not be considered to constitute such an arrangement;

(iv) any sales effort that is illegal or improper by the standards of the market in which it is made or involves the communication of false or misleading information; and

(v) the making of a sale to a purchaser with whom the vendor is not dealing at arm's length, in order to put the purchaser in a position where the purchaser may re-sell the securities free of constraints to which the vendor was subject."

We would submit that either Proposed MI 45-102 or its Companion Policy should contain a definition of or guidance on the meaning of "unusual effort", for the following reasons:

1. Alberta already has such guidance. It is anomalous that Alberta provides guidance but the other provinces do not.

2. There is potential for different interpretations of Proposed MI 45-102 by different provinces if a common interpretation is not adopted. Having different

interpretations of the same rule is hardly better than having different rules, since the effect in each case is to have different requirements in different provinces. Therefore, we would encourage the securities regulators to adopt a common interpretation to achieve the benefit of the single rule.

3. Failure to adopt a common interpretation results in unnecessary uncertainty in the market. For example, if the other provinces are unwilling to adopt Alberta's definition, is it because they interpret the term differently? Do they interpret it more or less restrictively? As it is, market participants in Alberta have the benefit of having clear guidelines as to what is permissible, while participants elsewhere do not.

We would suggest that the Alberta formulation be adopted since it has the benefit of long use and acceptance and is in line with the *Daon* ruling.

2. Sales by Pledgees

An area which continues to be troublesome is the position of pledgees and the choice between power of sale and foreclosure.[1] The history of what is s. 2.8 in both the Current Resale Rule and Proposed MI 45-102 suggests that the issue may not have been given as full consideration as it deserves when predecessor provisions were proposed.

Very briefly, after two earlier proposals and requests for comments, on October 20, 1995, the Ontario Securities Commission ("OSC") published for comment a proposed Rule entitled "The Early Warning System and Related Take-over Bid, Insider Trading and Control Block Distribution Issues" at (1995), 18 OSCB 4887 ("Early Warning Rule"). The principal purpose of the proposal was to create the exemptions from the early warning requirements which are now found in NI 62-103 – *The Early Warning System and Related Take-over Bid and Insider Reporting Issues*. An ancillary purpose was to "provide pledgees of securities with certain exemptions from control block distribution requirements and early warning requirements, and to restate the current provisions of section 25 of the Regulation as a rule in order to make such exemptions effective". This purpose was achieved through Section 8.1 of the Early Warning Rule which stated that the limitations on use of s. 72(7) of the Securities Act (Ontario) (i.e., what is now, in effect, s. 2.8 of Proposed MI 45-102) did not apply to "a distribution by a lender, pledgee, mortgagee or other encumbrancer (in this section the 'pledgee') for the purpose of liquidating a debt made in good faith by selling or offering for sale a security pledged, mortgaged or otherwise encumbered in good faith as collateral for the debt …"

[1] The distinction between the two remedies is based in the distinction between legal rights and equitable rights and the remedies available at law and in equity. Briefly put, foreclosure was an equitable remedy which allowed the holder of the security interest to terminate the borrower's equity of redemption; that is, the right to return of the property which had been mortgaged or pledged. This resulted in the debt being extinguished and the lender owning the property outright so it could be resold, free of the debtor's equity of redemption. The power of sale began as a contractual right and allowed the lender to sell the property, with the proceeds being used to repay the debt, and any excess being paid to the borrower. With respect to personal property, such as shares and other securities, the procedures for the two remedies are governed by applicable personal property securities laws.

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What is important in the present context is that the above language, which has been carried forward to s. 2.8 of Proposed Rule 45-102, was not considered to cover a realization by way of foreclosure, but only by way of power of sale; the commentary on s. 8.1 of the Early Warning Rule states that the "Commission invites specific comments as to whether prospectus relief would be appropriate or is necessary for foreclosure and/or sales following foreclosure on a similar basis." In other words, this appears to indicate that section 2.8 of Proposed MI 45-102 permits a pledgee to realize on its security by way of power of sale but not by way of foreclosure.

By letter dated February 1, 1996, Borden & Elliot (one of the predecessors to this firm) responded to the invitation to comment and recommended that similar relief for foreclosures be provided. The submission was as follows;

> "You have specifically invited comments on whether prospectus relief would be appropriate or necessary for foreclosures and/or sales following foreclosures. We believe that it is desirable to clarify the application of the Act in such circumstances, particularly for sales following foreclosures.
>
> It is unclear whether the act of foreclosure by a pledgee of securities derived from the holdings of a control person is a "trade" within the meaning of the Act (i.e., a disposition of the security or valuable consideration or some act in furtherance thereof). However, if foreclosure involves a "trade", based on a broad and purposeful interpretation of the Act, pledgees should be entitled to rely upon clause 72(1)(e), although admittedly the wording of the clause is less than clear in these circumstances. Obviously, it would be absurd from a policy standpoint to exempt the pledge of control block securities from the prospectus requirement but subject the realization upon such securities to the prospectus requirement.
>
> The more troublesome issue involves the pledgee's resale rights following foreclosure. Since foreclosure itself liquidates the debt at law, any sale of pledged control block securities by a pledgee subsequent to foreclosure would not be "for the purpose of liquidating a debt" and, thus, the prospectus exemption for pledgees under subsection 72(7) of the Act would not appear to be available. If a pledgee forecloses on pledged control block securities, any subsequent sale of such securities would not have the benefit of subsection 8.1(1) of the Proposed Rule and, accordingly, the pledgee would have to comply with the six month hold period prescribed by subsection 9.1(1) of the Proposed Rule.

> We do not believe that there is any policy reason that would justify this result nor do we believe that resale restrictions of pledged control block securities should be determined by the pledgee's choice of remedy. Accordingly, we would recommend that subsection 8.1(1) be amended to encompass a distribution by a former pledgee who has accepted the security in satisfaction of its debt."

On August 2, 1996, the OSC published a status report on the Early Warning Rule ((1996), 19 OSCB 4221) and, while it discussed the issue of pledged securities, it did not address the above comments or the question of foreclosure at all. The issue does not seem to have been pursued in the legislative process which followed leading up to the Current Resale Rule.

We also note that there are examples of orders having been made by the OSC to permit foreclosure (e.g., *Re Crownbridge Industries Inc.* (1988), 11 OSCB 26: *Re J.D.S. Investments Ltd.* (1996), 19 OSCB 4708).

We would submit that the arguments made in the Borden & Elliot letter remain valid and that there is no reason to distinguish between foreclosure and power of sale. In fact, we understand that, notwithstanding the history we have reviewed above, some market participants take the view that the language of s. 2.8 of MI 45-102 is broad enough to cover foreclosure. This view is supported by the fact that, since often there is little difference in economic effect or sale process, there should not be a different securities law treatment.

The argument is perhaps even stronger today in favour of identical treatment of power of sale and foreclosure. While commercial bank lending on the security of pledged shares continues to be the principal example of where this exemption would apply, it is not the only one. Increasingly, investment banks are creating sophisticated financial instruments which involve pledges and security arrangements. These instruments offer financial advantages to issuers, but may involve the financial institution having to accept securities in satisfaction of an obligation. There is no reason why the institution should be able to use power of sale to immediately effect a resale but not to foreclose and take the securities on its own books for subsequent resale. (As a collateral point, we note that to the extent that the Commissions are concerned that financial instruments may raise disclosure issues, these concerns appear to be addressed by proposed MI 55-103 – Insider Reporting for Certain Derivative Transactions (Equity Monetization).)

We would also suggest that, in a situation where the lender forecloses and takes possession of the securities without a specific purchaser in mind, the lender should be able to file the notice and, after seven days, take possession of the securities (subject, of course, to compliance with personal property security law and the terms of the security agreement). The lender would then hold the securities on the same basis as a third party purchaser. Form 45-102F1 may need to be revised to accommodate such situations by ensuring that a "sale" and "selling" include the act of foreclosing whereby the lender becomes the owner and the borrower's interest is extinguished.

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Accordingly, we would strongly urge the Commissions to clarify the situation and to explicitly amend s. 2.8 of Proposed MI 45-102 to cover foreclosure.

3. Time Periods Under Section 2.8

Our last comment is to suggest that section 2.8(5)(a) be modified to eliminate the "not more than 14 days" requirement in relation to filing of the Form 45-102F1. We assume that this requirement is to ensure that control block holders have a real and present intention to sell before filing a notice of intention. In practice, however, it forces sellers to make a sale prior to the expiry of 14 days even if market conditions have become unfavourable since the date of the notice. Such sales are often nominal, intended only to satisfy the timing requirement. A better procedure might be for the notice to lapse if no sale has been made within 30 days, subject to the right to renew.

* * *

Thank you for the opportunity of submitting comments. If you have any questions, please do not hesitate to contact me.

Yours very truly,

(signed): Paul A. D. Mingay

P. A. D. Mingay
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