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The Secretary
Ontario Securities Commission
20 Queen Street West
22nd Floor
Toronto, ON M5H 3S8

Dear Sirs/Mesdames:

Re: Proposed Offering Memorandum, Family, Friends Business Associates, Existing Securityholder and Crowdfunding Prospectus Exemptions

We are pleased to offer our comments on the Ontario Securities Commission's proposed offering memorandum prospectus exemption (the "OM Exemption"), family, friends and business associates prospectus exemption (the "FFBA Exemption"), existing securityholder prospectus exemption (the "Existing Securityholder Exemption") and crowdfunding prospectus exemption (the "Crowdfunding Exemption"), released for comment on March 20, 2014.

We previously submitted a comment letter in respect of the Canadian Securities Administrators' proposed amendments to the accredited investor and minimum amount investment prospectus exemptions. Some of our comments in that letter are applicable to the exemptions addressed in this letter.

Siskinds LLP is a leading Canadian plaintiff securities class action firm. We act in a broad range of shareholder rights litigation, with a focus on representing institutional and retail shareholders in securities class actions arising out of disclosure violations by issuers, their directors and officers, and other market participants. A number of cases in which we have acted as counsel have involved disclosure violations in the context of private placements.

In its effort to facilitate capital raising for businesses, in particular start-ups and small and medium sized enterprises ("SMEs"), through the introduction of the OM Exemption, the FFBA Exemption, the Existing Securityholder Exemption and the Crowdfunding Exemption, we believe that the Commission has tipped the balance too far in favour of issuers, and is neglecting the interests of investors. In particular, with respect to the proposed Crowdfunding Exemption, it is our view that the proposed exemption is misguided and, if enacted, will prove

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to be harmful to investors. The OSC should decline to introduce the Crowdfunding Exemption.

This comment letter is primarily focused on the Crowdfunding Exemption. We also have comments on other aspects of the proposed amendments, including the rights of action for damages or rescission that will be made available to investors who purchase under the proposed prospectus exemptions.

Crowdfunding

The risks and potential harm faced by investors if the Crowdfunding Exemption is introduced are neatly summed up in the discussion materials accompanying the proposed amendments:

> The Crowdfunding Prospectus Exemption will allow retail investors to participate in the various funding stages of start-ups and SMEs, providing broader access to investment opportunities. However, ***crowdfunding may be a highly risky investment and investors may experience a high probability of loss, even if there is no fraud. Many start-ups and SMEs are expected to fail.*** Canadian data shows that only 72% of SMEs that entered the marketplace in 2007 survived for two years and only 51% of SMEs that entered the market place in 2005 survived for five years. The survival rate of issuers that rely on equity crowdfunding may be lower since there is the possibility of adverse selection. Businesses with good prospects may gravitate towards donation or rewards-based crowdfunding or other cheaper sources of financing whereas less successful businesses may use securities-based crowdfunding because they are unable to raise funds from other sources.

Because crowdfunding will greatly increase access to the capital of unsophisticated investors without ensuring that those investors receive prospectus-level disclosure, it is virtually inevitable that crowdfunding will be accompanied by a much higher incidence of fraud. When that greatly increased incidence of fraud is combined with the fact that many of the businesses that will seek to raise capital under the Crowdfunding Exemption will fail, it is clear that investors will be exposed to a very significant risk of investment loss if this exemption is brought into force.

While it is proposed that the Crowdfunding Exemption would be available to both reporting issuers and non-reporting issuers, we would expect that the Crowdfunding Exemption would primarily be relied on by non-reporting issuers. For non-reporting issuers, with no disclosure record and no public market for secondary trading, investors will face numerous hazards in investing in such issuers, including the following fundamental issues:

- unlike more sophisticated venture capital or angel investors, retail investors will not have the expertise and access to information (notwithstanding the requirement for offering materials and ongoing disclosure in the proposed amendments) necessary to conduct proper due diligence before investing under the Crowdfunding

Exemption. In addition, given the individual investment limits, investors may not have the economic incentive to conduct due diligence and may be inclined to just follow the "crowd" (which will be similarly uninformed);

- there is an inherent conflict in having the directors/managers of the issuer determine the issue price for the private placement, and it will be difficult for investors to determine whether the issue price reflects a fair valuation of the issuer (given the lack of detailed disclosure and due diligence, and the absence of a public trading market to act as a proxy for the fair value of the securities);

- retail investors may not appreciate that there are restrictions on their ability to resell securities that they acquire under the Crowdfunding Exemption, both as a result of the resale restrictions under Ontario securities laws and the absence of a public trading market, and an illiquid investment is a far greater burden to an investor of limited means than it is to an investor of substantial means;

- investors under the Crowdfunding Exemption will have a stake in a private company, but will not have the benefit of the protections that would ordinarily be sought by a sophisticated investor investing money in a private company, such as a seat on the Board of Directors or specifically negotiated rights in a shareholders' agreement; and

- when investors suffer losses, the relatively small size of the investments on an individual and aggregate basis will mean that litigation will not be a viable mechanism for recovering the investment losses. That would apply even to a class action, in which smaller claims are aggregated to achieve efficiencies, because the value of the aggregate losses would likely render the class action uneconomical to pursue.

In our view, the limits and requirements built into the proposed Crowdfunding Exemption do not adequately address these fundamental issues with equity crowdfunding. From our perspective, the investments contemplated by the Crowdfunding Exemption are precisely the kind of investments for which prospectus-level disclosure should be required. Indeed, if anything, the Commission should require *better than prospectus-level disclosure* in respect of such investments, rather than a level of disclosure that is vastly inferior to that required to be contained within a prospectus.

Thus, we strongly urge the OSC to reconsider the proposed Crowdfunding Exemption. We note that a proposal is under consideration in the United States to enact a crowdfunding exemption to the registration requirement of U.S. securities laws for sales to non-accredited

investors. One benefit of not proceeding with the Crowdfunding Exemption in Ontario at this stage is that, if a crowdfunding exemption is introduced in the United States (which remains uncertain at this point in time), Canada could gain some insights into the operation of a crowdfunding exemption, and be better placed to introduce an exemption in the future, if it is felt that it is warranted at that time.

Rights of Action for Misrepresentation

With respect to the OM Exemption, and specifically in response to question 15 relating to that exemption, we agree with the proposal to require that any "OM marketing materials" provided to investors be incorporated by reference into the offering memorandum. It is appropriate for the statutory or contractual right of action for damages or rescission to extend to such marketing materials. The availability of the right of action will act as a deterrent to the making of misrepresentations in such materials, which are intended to influence the decision-making of prospective investors. We recommend that the rules also require an "OM standard term sheet" to be incorporated by reference into an offering memorandum. The offering memorandum, "OM marketing materials" and "OM standard term sheet" should be treated as a package of offering materials to which liability attaches.

With respect to the Existing Securityholder Exemption, based on the proposed amendments and discussion materials, our understanding is that investors' rights of action will be limited to a contractual right of action (set out in the subscription agreement) for damages or rescission in respect of misrepresentations in "documents" or "core documents", which would cover any "offering material"[1] as well as the reporting issuer's continuous disclosure documents. The contractual right of action described in proposed sub-section (4) is similar to the right of action under section 130.1 of the *Securities Act*. We further understand that consideration is being given to prescribing the Existing Securityholder Exemption under section 138.2(b) of the *Securities Act*, such that purchasers under the Existing Securityholder Exemption could avail themselves of the rights of action under Part XXIII.1 of the *Securities Act*.

In our view, the proposed contractual right of action is preferable to prescribing the Existing Securityholder Exemption under section 138.2(b) of the *Securities Act*. While the contractual right of action is available only against the issuer (and not, for example, against the reporting

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1 Because offering materials must be filed (pursuant to proposed sub-section (7)), those materials would fall within the definition of a "document" in section 138.1 of the *Securities Act* ("any written communication [...] that is required to be filed with the Commission").

issuer's directors and officers or experts), it is preferable to the rights of action under Part XXIII.1 of the *Securities Act* in a number of respects, including:

- there is a rescission remedy;
- there is no requirement to obtain leave of a court to enforce the right of action;
- the issuer's liability is not subject to a liability limit (damages cap); and
- the only defence available to the issuer is that the purchaser had knowledge of the misrepresentation.

It is not clear to us from the discussion materials whether a final decision has been made to prescribe the Existing Securityholder Exemption under section 138.2(b) of the *Securities Act*. Before steps are taken to do so, consideration must be given to how the contractual and statutory remedies will interact, because the characteristics of the rights of action are markedly different (in contrast to, for example, the statutory and contractual remedies for misrepresentations in an offering memorandum).

With respect to the Crowdfunding Exemption, we do not believe that extending the right of action under section 130.1 of the *Securities Act* (or a comparable contractual right of action) to misrepresentations in a "crowdfunding offering document" goes far enough in protecting investors.

First, it is deficient in conferring a right of action only as against the issuer. We note in that regard that the discussion materials (at page D-20) suggest that the right of action was intended to be available against the issuer, management, directors and portals (subject to a due diligence defence), but that is not provided for in section 130.1, nor is it reflected in the contractual right of action addressed in section 22 of proposed Multilateral Instrument 45-108. Given the heightened risks faced by investors purchasing under the Crowdfunding Exemption (as discussed above), and the kinds of businesses that are likely to seek access to capital under the Crowdfunding Exemption (start-ups and SMEs), we believe that rights of action should be available against a broader range of defendants. In particular, we note that a right of action against the issuer may be little more than an empty right if the issuer fails, in which case the issuer will in all probability have no or insufficient assets to satisfy a judgment in favour of investors (assuming that litigation can be economically pursued at all).

Second, we believe that the "crowdfunding offering document" should incorporate by reference other marketing materials (as contemplated by section 16 of proposed Multilateral Instrument 45-108) and, for reporting issuers, their continuous disclosure. That would be

consistent with the approach taken for the OM Exemption. We do not see a reason to treat the exemptions differently in this regard.

Third, there is an extremely tight limitation period applicable to actions under section 130.1 of the Ontario *Securities Act*. That limitation period is the lesser of three years from the date of the transaction and 180 days from the date of the discovery by the plaintiff of the facts underlying the claim. Crowdfunding will target less sophisticated investors, and in our view, they should have the benefit of the same limitation period as is generally available under section 4 of the Ontario *Limitations Act, 2002*, which is two years from the date on which the claim became discoverable, subject to an ultimate limitation period of 15 years.

Risk Acknowledgement Forms

The OM Exemption, the FFBA Exemption and the Crowdfunding Exemption each incorporate a requirement for the issuer to obtain a risk acknowledgement form from an investor. A key purpose of the risk acknowledgement forms appears to be to ensure that people investing under the relevant exemptions meet the eligibility requirements, which will primarily benefit issuers by protecting them from regulatory action for improper use of the prospectus exemptions. Any investor protection benefit seems secondary. As we stated in our comment letter on the accredited investor and minimum amount investment exemptions, we are sceptical that the proposed risk acknowledgement forms will have any material impact on an investor's decision as to whether to invest in a particular security. We again note that, based on our own inquiries, there appears to be little or no empirical research into the efficacy of risk acknowledgement forms in protecting investors. We recommend that adequate research be performed in that area.

Income and Asset Thresholds

We note that the OM Exemption incorporates net income and net asset thresholds in the definition of "eligible investor". As we stated in our previous comment letter with respect to the asset and income thresholds applicable to the accredited investor exemption, we believe that the asset and income thresholds should be adjusted periodically for inflation. The failure to do so will amount, over time, to an effective reduction in the thresholds, and because this reduction results from a failure to adjust to inflation, it lacks transparency. As we stated previously, if there is to be an effective reduction in the thresholds, it should be preceded by an invitation for comment and careful consideration of the various arguments for and against a reduction of the thresholds.

Thank you for your consideration of our comments.

Yours truly,

Siskinds LLP

Per: A. Dimitri Lascaris and Anthony O'Brien