McDougall Gauley
barristers & solicitors

Memorandum

To: Dean Murrison, Deputy Director Legal/Registration

From: Bill Nickel

Re: Comments on proposed National Instrument 45-106 *Prospectus and Registration Exemptions*

Date: 21 March 2005

I just wanted to thank you for the opportunity to comment on proposed NI 45-106. I believe that harmonization of the various registration and prospectus exemptions is important and I'd also like to thank the CSA for their efforts in this regard.

Rather than extolling of the virtues of the benefits of NI 45-106, I've confined my following comments to those areas where I had a question, concern, or suggestion regarding the exemptions contain in NI 45-106:

General Questions/Concerns pertaining to Saskatchewan only:

Is the SFSC proposed local instrument 11-502 *Removal of Statutory Exemptions* available for comment yet? I would be interested in seeing how this local instrument will be structured. Schedule 8 to the Consequential Changes Arising from Proposed NI 45-106 doesn't seem to shed much light on what is being proposed. How can the SFSC simply say that the exemptions in Section 38, 39, 39.1, 81 and 82 of the Act "are removed"? It seems to me that there are too many other instruments (such as MI 45-102 *Resale Rules*) that make reference to trades based on the exemptions granted under these sections to simply repeal them from the Act. I think it may also be too overbroad to simply say that all exemptions under such sections no longer exist. There may well be statutory exemptions under the Act and Regulations that should remain, regardless of the adoption of NI 45-106, in order to address particular situations that are possibly unique to our Province and to help promote raising of capital within our Province. We should not be seen to be doing away with all of our statutory exemptions just because we want to promote harmonization.

I was a little concerned that under the column entitled Comments/Change to the Saskatchewan Table of Concordance that a number of exemptions were to simply be eliminated following the adoption of NI 45-106. I suggest that there should be industry consultation within the Province before certain of these exemptions are eliminated, such

as the financial institution exemption and the promoters exemption. In specifically looking at the promoter exemption, I don't think it's fair to say in the Comments/Change column that the loss of this exemption in favour or the accredited (Part 2.4) and close friends (Part 2.5) exemption represents no change. Reliance on either the accredited or close friends exemption under NI 45-106 requires the filing of a Report on Exempt Distribution. I believe this is a significant change (and administrative cost) over what was previously required under the promoters exemption under the Act.

Is Saskatchewan General Ruling/Order 45-912 *Exemptions for Co-operatives and Credit Unions* available for review and/or comment? I think it's particularly important for the Credit Union and Co-operative systems to know what the content of that GRO is in order to determine what the impact will be on them respecting the proposed elimination of the financial institution exemptions currently available to them under the Act.

Respecting the close personal friend and close personal business associate exemption, will a modified form of Staff Notice 45-701 remain in effect to permit pre-clearance of any questionable relationships, or has Staff Notice 45-701 been rescinded with the change in the review policy that occurred when MI 45-103 was adopted in Saskatchewan?

Comments on proposed NI 45-106:

- Definition of "eligibility advisor". While I appreciate and agree that, due to our sparse population and limited resources, it is appropriate to include lawyers and accountants as eligible advisors in Saskatchewan and Manitoba, I have a concern with respect to the qualifications in that such qualifications seem so broad as to create uncertainty. How can a lawyer or accountant know, without performing a lot of time consuming background checks and investigations, if the person they have been retained by has ever acted for or been retained by the issuer, or its directors or officers? This would seem to create a disproportionate amount of effort in order to avoid the potential harm. The real concern, I believe, is that the lawyer or accountant has either a direct or indirect relationship with the issuer, so why not just say that. It should also be remembered that both lawyers and accountants are licensed and subject to disciplinary proceedings by self regulatory organizations, much the same as IDA members. It seems counterproductive to me that an IDA member should be entitled to have an indirect interest in an issuer and yet the lawyer or accountant shouldn't. So long as the lawyer or accountant isn't paid directly or indirectly by the issuer for providing such investment advice (so that there can be no question as to who the client is) it would seem to me that the code of professional conduct applicable to both the lawyer and accountant would require them to represent their client (the potential investor) to the best of their ability. I know this definition is a carry forward from MI 45-103, but perhaps this is an opportunity to make this concession for Saskatchewan and Manitoba more useful.

- Definition of "private issuer". Given the restrictions on who may invest in a private issuer [see Item 2.4(1) of NI 45-106], it seems unnecessary to me that the regulators seek to pierce the corporate veil and require an issuer to include in its calculation of the 50 shareholder cap those shareholders, beneficiaries or partners of a company, trust or partnership established to facilitate the investment by those persons in the issuer. If the directors or beneficial owners of such an entity have, by majority decision, decided to invest in the securities of a private issuer then the regulators should not question that decision. Nor should the regulators be seen to be imposing restrictions on how an issuer chooses to structure themselves. I'd suggest that the definition of "private issuer" revert to the definition currently found under MI 45-103.

- Part 2.9(13) – amendments to the Offering Memorandum – Having now had the opportunity to conduct a few exempt offerings in reliance on the Offering Memorandum exemption of Part 4 of MI 45-103, I'd like the regulators to consider revising Part 2.9(13) of NI 45-106. I suggest that Part 2.9(13) of NI 45-106 (which is based on Part 4.4(4) of MI 45-103) is unnecessarily cumbersome. Part 4.4(4) of MI 45-103 (as would Part 2.9(13) of NI 45-106) requires that an issuer have the subscription agreements re-signed each time there is an update or amendment to the Offering Memorandum. While it is important that investors receive this updated information, the requirement to have each subscriber re-sign their subscription agreement has, in my experience, generated a lot of negative feedback. Most notably, subscribers do not wish to spend their time re-signing the subscription agreement and believe that to do so is an unnecessary intrusion. This not only negatively affects the goodwill of the issuer, but also casts the regulators (who are blamed for this intrusion) in a less than favourable light. As with prospectus offerings, I suggest that the better alternative is to simply require the issuer to send a copy of the amendment to subscribers and confirm that subscribers have a 2 day right of rescission. It should be up to the subscriber to decide whether or not to exercise that right of rescission. It should not be necessary for the issuer to follow-up with each subscriber to obtain a new or re-signed subscription agreement. The requirement that each subscriber re-sign their subscription agreement does not add anything to the protection of such subscriber and makes the use of this exemption administratively cumbersome.

- Part 2.9(11) – Offering Memorandum exemption and the certificate page to Forms 45-106F3 and F4. Should the requirement that the certificate page be signed by a "promoter" be changed to "founder" (as such term is defined in NI 45-106)? I'd suggest that it is not necessary to have a promoter who is not also a founder (i.e. still actively engaged in the business) sign the certificate and accordingly I'd suggest changing the reference from "promoter" to "founder". Just because a person has a 10% interest in an issuer doesn't necessarily mean that such person has any more knowledge about the issuer if such person is not also actively engaged in the issuer's business.

- Part 2.11(1) – Business Combination and reorganization – The requirement to issue a disclosure document to security holders presents an unreasonable requirement on private issuers and small issuers that do not qualify as a private issuer. I acknowledge

that this requirement exists in BC (see sections 45(2)(9)(ii) and 74(2)(8)(ii) of their Act), but it has not previously existed in Alberta (see sections 86(1)(m)(ii) and 131(1)(f)(ii)), Saskatchewan (Sections 39(1)(m)(ii) and 81(1)(f)(ii)), Manitoba (sections 19(1)(h.3) and 58(1)(b)) and Ontario (sections 35(1)(12) and 72(1)(f)(ii)). I didn't have time to check the remaining provinces and territories.

Under corporate law, any fundamental change in the structure of an issuer may trigger the requirement for shareholder approval. However, there are circumstances where such shareholder approval is not needed (such as the spin out of a subsidiary or assets to a new company where those assets do not constitute all or substantially all of the assets of the issuer). In those circumstances it is unreasonable for the CSA to insist that shareholder approval be obtained when no such approval is required under corporate law. Further it is unreasonable for the CSA to insist that an information circular in the prescribed form must be used in all circumstances (even if shareholder approval is needed under corporate legislation). It should be remembered that, under corporate law, only companies who have more than 15 shareholders need to do a mandatory proxy circulation. Companies with fewer than 15 shareholders do not need to do a mandatory proxy solicitation and therefore do not need to issue an information circular. Moreover, small companies (even some closely held companies with more than 15 shareholders) will often meet the shareholder approval requirement through a written consent resolution in lieu of a shareholders meeting as is permitted under corporate law. Inclusion of this mandatory disclosure/shareholder approval requirement is unduly restrictive and may well, due to the disproportionate cost of compliance, preclude small companies (who are more apt to use this exemption) from being able to use it. Note that the private issuer exemption doesn't apply in these circumstances as no securities are actually being purchased in a reorganization. Typically a reorganization involves a share exchange without further consideration having to be paid.

A further problem with Item 2.11(1)(b)(ii) is that it seems to imply that unanimous shareholder approval is required, which is contrary to corporate law where approval by special resolution is all that is needed. Further, it is not clear whether all shareholders are entitled to vote in respect of such approval. Under corporate legislation, the resolution respecting a reorganization is only required to be put to those shareholders who are entitled to vote on such resolution. In the case of non-voting shares, if the rights of the holders of non-voting shares are not being affected by a proposed reorganization, such shareholder is not entitled to vote on the resolution to approve such reorganization.

I strongly urge the regulators to reconsider Part 2.11(1). I submit that BC has got it wrong (in that they have made this exemption too restrictive), and that the broader exemption as currently found in AB, MB, SK, and ON is the preferred form of the exemption. The regulators should not be seen to be imposing a requirement that shareholder approval is need in all cases where a reorganization is contemplated, when no such requirement for shareholder approval exists under applicable corporate legislation. If the regulators make this exemption too restrictive I submit that they will

be inadvertently forcing small issuers to seek discretionary relief from the requirement to circulate mandatory information circulars and obtain shareholder approval.

- Part 2.30 – Incorporators exemption – If this exemption is to be limited to 5 persons, then I don't see it as being useful. However, if the regulators were to remove the cap of five investors this exemption could be much more useful. There seems to be no particular reason for limiting this exemption to 5 persons. Sometimes, such as in community based projects, there are many more than 5 incorporators or organizers who only pay nominal consideration for their shares (additional capital is raised under alternate exemptions – and often in these cases from persons who may or may not be the same as the incorporators or organizers). Previously, these investors may have qualified under the promoters exemption (for which there were no filing requirements), but I understand that this exemption is to be lost in favour of the accredited investor or close friends exemption (both of which have filing requirements). If the promoters exemption is to be made unavailable to issuers, then I'd suggest the retention of the incorporators exemption but only if the cap on 5 investors is removed.

- Part 2.42 – Schedule III Banks and Cooperative Associations – with the possible removal of the financial institutions exemption currently available under applicable securities laws, I'd like to suggest that the registration exemption and prospectus exemption for trades in evidences of deposit under NI 45-106 should be expanded to apply to all Canadian financial institutions and Schedule III banks, as such terms are defined in NI 45-106.

Comments on proposed Form NI45-106F1 *Report of Exempt Distribution*:

This form seems to build on the information previously required by Form 45-103F4. I am concerned that the CSA appears to be requesting/amassing information that is unnecessary, and not without administrative cost to the issuers who wish to use such exemptions.

In particular, I'm concerned that:

- Item 2: For exempt trades, it should not be relevant whether the issuer is a reporting issuer and if so the jurisdictions where they are a reporting issuer. The only reason for such a request would be to amass statistical information which I suggest is outside the mandate of the securities regulatory authorities, and the risk of such information being used for an improper or undisclosed purpose is too great. I'd suggest that Item 2 should be deleted from Form 45-106F1.

- Item 3: I see no reason why the CSA should be requesting the issuer to identify what industry they are engaged in. The only reason for such a request would be to amass statistical information which I suggest is outside the mandate of the securities regulatory authorities, and the risk of such information being used for an improper or

undisclosed purpose is too great. I'd suggest that Item 3 should be deleted from Form 45-106F1.

- Item 4 and Schedule I: I do not think it is appropriate for regulatory authorities to be seeking the name, address and telephone number of investors. The only reason regulators would want the telephone number of an investor is so that a commission could perform a spot audit to determine if the issuer was entitled to rely on the particular exemption claimed. In the absence of a complaint, I suggest that it is unreasonable for a commission to believe that it should substitute its belief as to whether or not there is a sufficient nexus or basis for justifying a particular trade based on an exemption in place of the determination of the issuer and investor. As highlighted in Item 1.9 of Companion Policy 45-106CP, it is the issuer that is responsible for determining if a particular exemption is available in the circumstances. Further, the issuer has certified in Form 45-106F1 that the information is accurate, and it is the issuer that would be liable if that certification ultimately proved to be incorrect. In the absence of a complaint, I suggest that it is procedurally unfair for a regulator, in its capacity as an investigatory body, to contact an unrepresented investor (who may not appreciate the technical requirements that need to be met in order to justify reliance on a particular exemption) to elicit information about an issuer and/or particular trade. Further, this fails to take into account the personal privacy of the investor. What if the investor doesn't want to be contacted by a commission or doesn't want their telephone number disclosed? Please note that an unlisted phone number of an individual is personal information for the purposes of the *Personal Information Protection and Electronic Documents Act* (Canada), and the regulators should be aware of the provisions of section 7(3)(c.1) of PIPEDA that requires the regulators to disclose their lawful authority for making such request. I've read Part 5.1 of Companion Policy 45-106CP respecting the expression of intent that the regulators will not disclose the information on Schedule I to the public, but I don't believe this assists an issuer with its obligations under PIPEDA regarding the collection or retention of such information. Further, in the event an individual makes a request under PIPEDA that a regulator provide such individual with a copy or summary of any information in the regulators records pertaining to such individual, are the regulators prepared to comply with such request? For all of the forgoing reasons I'd suggest that the inclusion of the requirement to obtain and disclose the telephone number of investors be removed from Schedule I.

- Item 8: If this information is necessary in order to qualify an exempt trade, I suggest that it should be made clear that the "exemption being relied on" is the exemption for payment of the commission, not the exemption on which the underlying security was traded in reliance on. I've seen too many issuers, both represented and unrepresented, that don't appreciate the distinction and simply insert the exemption relied on for the underlying trade. Further, in the case of brokers (registered dealers) acting as sales agents, I'd suggest the inclusion of a note in the instructions clarifying that only the lead sales agent (broker) need be identified and not each sub agent. Further, I think it should be made clear in the instructions that, in the case of brokers acting as sales

agents, the issuer does not need to identify each investment advisor who facilitated sales on behalf of the broker.

Comments on proposed Form NI45-106F5 Saskatchewan Risk Acknowledgement:

It seems unnecessary that Saskatchewan should be the only jurisdiction to require a separate risk acknowledgement for trades in reliance on the close friends or business associates exemption.