

Summer 2003: Corporate Finance & Securities

New Capital Raising Exemptions in Saskatchewan

◆ Exemptions Create Fundamental Change to Private Placements

On June 16, 2003 the Saskatchewan Financial Services Commission, Securities Division (the "SFSC") adopted new rules that will fundamentally change the nature of private placements in Saskatchewan. Multilateral Instrument 45-103 - Capital Raising Exemptions ("MI 45-103") of the Canadian Securities Administrators, which commenced as an initiative in British Columbia and Alberta, is now available in British Columbia, Alberta, Saskatchewan, Manitoba, Nova Scotia, Prince Edward Island, Newfoundland and Labrador, Northwest Territories and Nunavut and is intended to harmonize the key capital raising exemptions in those provinces.

OVERVIEW

MI 45-103 provides four new exemptions from the registration and prospectus requirements:

1. A private issuer exemption that will make it easier for "private issuers" to raise venture capital funding from insiders, family members, close personal friends and close business associates, as well as "accredited investors", while remaining private, and for shareholders of private issuers to resell their securities;
2. A family, friends and business associates exemption that will make it easier for issuers that are not private issuers, and their security holders, to trade securities to insiders, family members, close personal friends and close business associates;

3. An accredited investor exemption permitting trades of securities to persons who qualify as an "accredited investor"; and

4. An offering memorandum exemption permitting issuers to sell securities in any amount (provided purchases in excess of \$10,000 are by certain eligible investors) if they obtain a new prescribed form of risk acknowledgement from investors and deliver an offering memorandum in a new prescribed form, which may provide a significant alternative to prospectus financings where investors are willing to accept a resale restriction.

New rules provide four new exemptions from the prospectus and registration requirements.

The exemptions provided by MI 45-103 are in addition to the existing registration and prospectus exemptions contained in *The Securities Act, 1988* (Saskatchewan) (the "Act"). However, in the future the SFSC may seek repeal of certain exemptions contained in the Act that overlap with MI 45-103, including the existing private issuer exemption, the close friends and business associates exemption, the financial institutions exemption and the \$150,000 private placement exemption. Until they are repealed an issuer may choose to rely on the statutory exemptions or the MI 45-103

exemptions.

This Securities Update summarizes the significant features of the new exemptions and highlights particulars that are specific to Saskatchewan. Reference should be made to MI 45-103, the accompanying companion policy and related forms for full details of the terms of the new exemptions.

PRIVATE ISSUER EXEMPTION

The private issuer exemption exempts trades in securities of a “private issuer” from the registration and prospectus requirements if the purchaser purchases as principal and is:

- a director, officer, employee, founder or control person of the issuer;
- a spouse, parent, grandparent, brother, sister, child, close personal friend or close business associate of a director, senior officer, founder or control person of the issuer;
- a parent, grandparent, brother, sister or child of the spouse of a director, senior officer, founder or control person of the issuer;
- a spouse, parent, grandparent, brother, sister or child of the selling security holder, or of the selling security holder's spouse;
- a current holder of designated securities (as defined below) of the issuer;
- an accredited investor;
- a person (which includes a partnership, trust or estate) or company of which a majority of the voting securities are beneficially owned by any combination of the persons or companies described above;
- a trust or estate of which all of the beneficiaries or a majority of the trustees are persons or companies described above; or,
- a person or company that is not the public.

A “private issuer” is defined as an issuer:

- that is not a reporting issuer, mutual fund or non-redeemable investment fund;
- whose designated securities are:
 - i) subject to restrictions on transfer that

are contained in the issuer's constating documents or security holders' agreements; and

ii) are beneficially owned, directly or indirectly by not more than 50 persons or companies, counting any two or more joint registered owners as one beneficial owner, and not counting employees and former employees of the issuer or its affiliates; and

- that has distributed designated securities only to persons or companies described above.

The term “designated securities” generally excludes debt securities. As a result, holders of non-convertible debt securities would generally be excluded in calculating the number of designated security holders. In addition, the issuer can sell non-designated securities, such as debt, to purchasers who are not described in the list above without losing its private issuer status. Under the new private issuer exemption an issuer will not cease to be a private issuer by virtue of distributing securities to persons specifically listed in the exemption (including accredited investors) whether or not such persons might constitute the “public”.

The Private Issuer Exemption provides substantial additional opportunities to pursue venture capital financing .

This exemption provides substantial additional opportunities for private issuers to pursue venture capital financing without the use of a securities dealer or the need for a prospectus. In these circumstances, however, it will still be necessary to determine whether the constating documents of the issuer include any restrictions against offering or issuing securities to the public. It is also important to note that under this exemption no commission or finder's fee may be paid to any director, officer, founder or control person of an issuer, except in connection with a trade to an accredited investor.

ACCREDITED INVESTOR EXEMPTION

The accredited investor exemption permits trades in securities of an issuer, including an

issuer that is not a private issuer, in any amount to any person or company that qualifies as an “accredited investor”. Under this exemption, no minimum amount must be invested. There is also no limit on the number of times this exemption can be used by the issuer or on the number of purchasers which may use it. Additionally, accredited investors can use the exemption to resell securities in any dollar amount to other accredited investors.

Accredited investors include high net worth individuals .

Accredited investors include Canadian banks, trust companies, registered advisers and registered dealers, governments and pension funds. Notably, the accredited investor definition also encompasses individuals and smaller entities. The list of accredited investors in Saskatchewan includes, among others:

- an individual who beneficially owns, alone or together with a spouse, financial assets (cash and securities) having an aggregate realizable value, before taxes, but net of any related liabilities, exceeding \$1,000,000;
- an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of those years, and who, in either case, reasonably expects to exceed such net income level in the current year;
- a registered charity under the *Income Tax Act* (Canada) that, in regard to the trade, has obtained advice from a lawyer, public accountant, investment dealer or other adviser registered to provide advice on the securities being traded;
- a person or company, other than a mutual fund or non-redeemable investment fund, that had net assets of at least \$5,000,000 as shown on its most recently prepared financial statements; and
- a person or company in respect of which all

of the owners are persons or companies that are accredited investors.

The exemption does not require that an offering memorandum or other disclosure document be provided to a potential investor. As well, as is the case for the private issuer exemption and the family, friends and business associates exemption, the accredited investor exemption can also be relied upon by security holders to resell securities.

FAMILY, FRIENDS AND BUSINESS ASSOCIATES EXEMPTION

This exemption will permit securities of an issuer, including an issuer that is not a private issuer, to be sold in any amount if the purchaser purchases as principal and is:

- a director, senior officer, control person of the issuer, or of an affiliate of the issuer;
- a spouse, parent, grandparent, brother, sister, child, close personal friend or close business associate of a director, senior officer or control person of the issuer, or of an affiliate of the issuer;
- a parent, grandparent, brother, sister or child of a spouse of a director, senior officer or control person of the issuer, or of an affiliate of the issuer;
- a founder of the issuer or a spouse, parent, grandparent, brother, sister, child, close business friend or close business associate of a founder of the issuer;
- parent, grandparent, brother, sister or child of the spouse of a founder of the issuer; and
- a person or a company of which a majority of the voting securities are beneficially owned by any combination of the persons or companies described above.

The companion policy to MI 45-103 provides guidance regarding the meaning of the expressions “close personal friend” and “close business associate”.

In Saskatchewan, any person or company trading securities under the family, friends and business associates exemption based on a close personal friendship or close business

association must obtain from the Saskatchewan purchaser a signed Form 45-103F5 "Risk Acknowledgement - Saskatchewan Close Personal Friends and Close Business Associates". The issuer is responsible for determining whether the close personal friendship or close business association exists. Additionally, in Saskatchewan no commission or finder's fee may be paid to any person or company in connection with a trade to a purchaser in Saskatchewan under this exemption.

Sales to a large number of persons may create a presumption against the family, friends and business associates exemption.

The companion policy to MI 45-103 indicates that, although there is no restriction on the number of persons the issuer may sell to under this exemption, if the issuer sells securities to a large number of persons this may create a presumption that not all of the purchasers are family, close personal friends or close business associates and that the exemption might not be available.

Similarly, the companion policy indicates that advertising to solicit or find purchasers is not restricted under any of the new exemptions, and that MI 45-103 does not prohibit the use of registrants, finders and telemarketing or advertising in any form (for example, internet, email, direct mail, newspaper or magazine) to solicit or find purchasers. However, if any of these means are used to find purchasers (other than accredited investors) under the new private issuer exemption or the new family, friends and business associates exemption, it may create a presumption that the relationship required for use of the exemptions is not present.

This exemption does not require that an offering document or other disclosure document be provided to an investor or potential investor. If an offering document is provided, it is not required to be in a prescribed form and does not currently trigger any statutory rights of action for purchasers. However, a purchaser would still be able to pursue a common law remedy.

OFFERING MEMORANDUM EXEMPTION

The offering memorandum exemption permits an issuer to sell its securities in any amount if the issuer obtains a signed risk acknowledgement in the prescribed form from the purchaser purchasing as principal at the time or before the purchase agreement is signed, and the issuer delivers an offering memorandum (which must be filed with the SFSC) in the prescribed form. The offering memorandum must also include a certificate certifying that the offering memorandum does not contain any misrepresentations. The exemption is not available to permit trades from anyone other than the issuer.

If an issuer is offering securities under the offering memorandum exemption, a purchaser cannot acquire more than \$10,000 of securities in a particular distribution unless the purchaser is an "eligible investor". Generally, an eligible investor in Saskatchewan includes a person or a company that:

- meets certain financial tests (ie. \$75,000 pre-tax net income or \$400,000 net assets); or
- has obtained advice regarding the suitability of the investment from a lawyer, public accountant, investment dealer or other adviser registered to provide advice on the securities being traded.

No commissions or finder's fees are permitted, other than to registered dealers.

In Saskatchewan no commission or finder's fee may be paid to any person or company, other than a registered dealer in connection with a trade to a purchaser under this exemption.

Once created, an offering memorandum may be used repeatedly for various offerings. However, the offering memorandum must be updated to incorporate annual financial statements and, in the case of a qualifying issuer, its current annual information form. The offering memorandum must also be updated if circumstances change such that the offering

memorandum contains a misrepresentation. There are two forms of offering memorandum - one for “qualifying issuers” and one for “non-qualifying issuers”. A “qualifying issuer” is an issuer which would be a qualifying issuer under Multilateral Instrument 45-102 - Resale of Securities (a reporting issuer that is a SEDAR filer with a current AIF and with equity shares listed on a qualified market). A qualifying issuer may use a form which permits it to incorporate by reference certain previously and subsequently filed disclosure documents rather than reproducing that information in its offering memorandum.

It is important to note that the new forms of offering memorandum are significantly different from the previous forms prescribed under existing securities legislation. The new forms have been designed with the intention that they will be simpler and easier for issuers to prepare and easier for investors to read and understand. However, the financial statement requirements in the new prescribed forms are more onerous than under the previous form.

An issuer is required to provide a two-day right of withdrawal to a purchaser acquiring securities under the offering memorandum exemption and arrange for the consideration to be held in trust

during this period. In addition, there are requirements to provide contractual rights of action. The contractual right of action for damages expires on the earlier of 180 days after the purchaser first has knowledge of the misrepresentation and three years after the date of execution of the agreement. However, such right of action is subject to the defence that the purchaser had knowledge of the misrepresentation at the time of purchase.

REPORTING REQUIREMENT

MI 45-103 requires an issuer relying on the accredited investor exemption, the family, friends and business associates exemption, or the offering memorandum exemption to file a Form 45-103F4 report of exempt distribution within 10 days of the distribution.

ADVERTISING

Advertising to solicit or find purchasers is not restricted under any of the exemptions in MI 45-103. However, issuers must comply with the other requirements and restrictions on such activities in Saskatchewan, including the requirements of Saskatchewan Local Instrument 45-501 - Marketing Communications. ♦

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