

## Private Placement Rules Across Canada – National Instrument 45-106 *Prospectus and Registration Exemptions*

On September 14, 2005 National Instrument 45-106 *Prospectus and Registration Exemptions* (“NI 45-106”) came into force and implemented significant changes to the regulatory regime governing the “exempt market” in all Canadian jurisdictions. The exempt market is the market in which securities are sold in reliance on exemptions from the registration and prospectus requirements under Canadian securities laws. NI 45-106 creates a harmonized, but not identical, set of rules by replacing most local exemptions and consolidating the majority of the local exemptions into one instrument. This article briefly describes seven of the most commonly used exemptions and highlights some of the principal changes from the previously existing rule.

### Accredited Investor Exemption

NI 45-106 allows the distribution of securities in any dollar amount to an unlimited number of investors in any Canadian jurisdiction, provided that each investor is purchasing the securities as “principal” (i.e., not for the benefit of others) and qualifies as an “accredited investor” within the meaning of NI 45-106. The categories within the definition of accredited investor have been harmonized under NI 45-106 and include:

- individuals (alone or with a spouse) with net financial assets over \$1 million or with net assets of at least \$5 million;
- individuals whose net income before taxes exceeds \$200,000 (or \$300,000 with a spouse) in each of the past two calendar years and who reasonably expect to exceed that income level in the current year;
- certain Canadian financial institutions and Schedule III banks;
- public and certain private investment funds;
- registered charities that have received advice in connection with the purchase of securities;
- corporations, limited partnerships, trusts or estates with net assets of at least \$5 million; and
- entities that are directly, indirectly or beneficially owned solely by accredited investors.

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Of note, this exemption is now available in Québec without the requirement to file a notice with the Autorité des marchés financiers. Additionally, the accredited investor exemption does not require the use of an offering memorandum or any other form of disclosure document. However, this exemption cannot be used to trade a security if the entity seeking to rely on the exemption has been created solely to hold net assets of at least \$5 million and thereby qualify as an accredited investor.

### Minimum Purchase Exemption

In the past, most Canadian jurisdictions had an exemption based on a minimum investment amount. Now, NI 45-106 provides a uniform “minimum purchase” exemption that applies in all provinces and territories in Canada. Under this exemption, an investor must purchase or be deemed to purchase the securities as “principal” (i.e., not for the benefit of others) and the securities must have an aggregate acquisition cost of not less than \$150,000. In addition, the securities purchased must be those of a single issuer; however, different kinds of securities, such as debt securities and equity securities, may be traded as part of one transaction with reliance on this exemption.

### Private Issuer Exemption

NI 45-106 allows a select group of investors to purchase securities from a “private issuer” without having to comply with the prospectus and registration requirements. This exemption is available in all of the provinces and territories of Canada including Ontario and Québec. “Private issuer” is defined as an issuer;

- (a) whose securities, other than non-convertible debt securities, are subject to restrictions on transfer that are contained in the issuer’s constating documents or security holders’ agreements;
- (b) whose securities are beneficially owned, directly or indirectly, by not more than 50 persons, not including employees and former employees of the issuer or its affiliates; and
- (c) has only distributed securities to a select group of persons (listed below).

As described above, in order to use this exemption an issuer must have only issued securities to a select group of persons. In particular, the exemption is available for trades in a security of a private issuer if the purchaser is purchasing the security as principal and is:

- a director, officer, employee, founder or control person of the issuer;

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- a spouse, parent, grandparent, brother, sister or child of the spouse of a director, executive officer, founder or control person of the issuer;
- a parent, grandparent, brother, sister or child of the spouse of a director, executive officer, founder or control person of the issuer;
- a close personal friend of a director, executive officer, founder or control person of the issuer;
- a close business associate of a director, executive 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;
- an existing security holder of the issuer;
- an accredited investor;
- an entity of which a majority of the voting securities are beneficially owned by, or a majority of the directors are, persons described above;
- a trust or estate of which all of the beneficiaries or a majority of the trustees or executors are persons described above; or
- a person who is not the public.

It is worth noting that no finder's fee may be paid to any director, officer, founder or control person of an issuer in connection with the trade of securities of the issuer in reliance on the private issuer exemption, unless the trade is to an "accredited investor". This exemption is not available if the person seeking to rely on it was created or used solely to make use of this exemption.

### Affiliates Exemption

NI 45-106 permits the trade by an issuer of securities of its own issue to an affiliate of the issuer that is purchasing as principal. For the first time, this exemption is available in all of the provinces and territories of Canada. An issuer is an "affiliate" of another issuer if one of them is the direct or indirect subsidiary of the other or if each of them is controlled by the same entity.

NI 45-106 defines "subsidiary" as an issuer that is controlled, directly or indirectly, by another issuer. Under NI 45-106, a person (first person) is considered to control another person (second person) if:

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- the first person, directly or indirectly, beneficially owns or exercises control or direction over securities of the second person carrying votes which, if exercised, would entitle the first person to elect a majority of the directors of the second person, unless that first person holds the voting securities only to secure an obligation;
- the second person is a partnership, other than a limited partnership, and the first person hold more than 50% of the interests of the partnership; or
- the second person is a limited partnership and the general partner of the limited partnership is the first person.

### Business Combination and Reorganization

In the past, most Canadian jurisdictions had an exemption that was available to be used to trade securities in connection with an amalgamation, merger, reorganization or arrangement; however, such exemption was not available in all jurisdictions and the existing exemptions varied significantly across jurisdictions. Now, NI 45-106 permits a trade in a security in connection with:

- an amalgamation, merger, reorganization or arrangement that is under a statutory procedure;
- an amalgamation, merger, reorganization or arrangement that is described in an information circular prepared pursuant to the applicable continuous disclosure rules, or a similar disclosure document that is delivered to each security holder and whose approval of the amalgamation, merger, reorganization or arrangement is sought and received; or
- a dissolution or winding-up of the issuer.

With the implementation of this exemption, issuers who are reporting issuers in various provinces or territories across Canada can effect a corporate reorganization without having to seek individual exemption orders from securities regulatory authorities. In addition, securities regulatory authorities have indicated that “statutory procedure” will be interpreted broadly and that this exemption can be used for all trades in securities of an issuer necessary to complete the transaction, regardless of when the trades occur. Further, references to “statutory procedure” are to any statute, be it local or foreign, under which the issuer has been created or the transaction is taking place.

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### Offering Memorandum

NI 45-106 contains two version of an “offering memorandum” exemption – one very broad exemption operates in British Columbia and most of the Atlantic provinces, and another narrower exemption operates in Alberta, Quebec and the remaining provinces and territories. Neither version is available in Ontario.

In all NI 45-106 jurisdictions, other than Ontario, the offering memorandum exemption requires that the purchaser:

- (a) purchase the offered securities as principal;
- (b) receive an offering memorandum at the same time or prior to the execution of an agreement to purchase the securities; and
- (c) sign a risk acknowledgement in the prescribed form.

In addition to these basic requirements, Alberta, Manitoba, the Northwest Territories, Nunavut, Prince Edward Island, Québec and Saskatchewan restrict the application of the offering memorandum exemption to purchasers who either:

- (a) invest \$10,000 or less in the offering; or
- (b) invest more than \$10,000 and meet the criteria of an ‘eligible investor’ as defined in NI 45-106 (being a person whose net assets or net income exceeds certain specified levels which are lower than those required for accredited investor status).

An issuer using the offering memorandum exemption in a particular province or territory must file the offering memorandum with the applicable regulator within the prescribed deadlines. In addition, purchasers of securities under the offering memorandum have specific statutory and/or the contractual rights of action in connection with a misrepresentation in an offering memorandum that they have relied upon to make their purchase; however, these rights may vary from province to province.

### Family, Friends and Business Associates

A prospectus and registration exemption for trades to family, friends, business associates and founders was formerly available in all jurisdictions other than Ontario and Québec. NI 45-106 preserves this exemption and extends its availability to Ontario and Québec. In all jurisdictions other than Ontario, the exemption extends to executive officers, directors and control persons of the issuer and certain of their close family, friends and business associates; in Ontario, it is more restrictive.

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Issuers should note, however, that jurisdictional differences still remain. Saskatchewan, for instance, requires a signed risk acknowledgement from close friends and business associates, where the other jurisdictions do not. Another example is that in Ontario, the exemption is only available in connection with the distribution of securities to a founder or affiliate of a founder of the issuer, or a spouse, parent, brother, sister, grandparent or child of an executive officer, director or founder of the issuer or a control person of the issuer.

Introduction of this exemption in Québec is significant as, in the past, distributions could only be made to such persons if the issuer was a "closed company" for the purposes of the *Securities Act* (Québec), with the issuer having to make a determination based on tests set forth in jurisprudence and decisions of various securities commissions as to whether the prospective investors constitute the "public" vis à vis the issuer.

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If you have any questions regarding NI 45-106, please contact any member of the Securities and Capital Markets group at BLG.

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