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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

"During the last year...one set of new [securities law] rules that applies to all provinces...has come into force in one important area – raising money privately."

This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial group, Steve Popoff at 416.593.3972 or spopoff@blaney.com.

NEW PRIVATE PLACEMENT RULES MAKING IT EASIER FOR BUSINESSES TO RAISE MONEY

Nadim Wakeam

Canada may be one country but, when it comes to the sale and purchase of a company's stock, bonds, debentures or other securities, we have 13 different sets of rules and regulations. Historically, this has complicated efforts to do business in capital markets nationally, inhibited the ability of companies to raise funds, and led to repeated calls for the establishment of one national securities regulator.

Despite several determined attempts, Canada seems no closer to one securities regulator today than it did a decade ago. That is not to say there has been no progress in harmonizing regulation across the country. During the last year, in fact, one set of new rules that applies to all provinces and territories has come into force in one important area – raising money privately.

This new regime governs prospectus and registration exemptions for private placements everywhere in Canada. It is easing the job of companies looking to raise capital to launch new ventures or tide them over until their receivables are paid.

A prospectus sets out the particulars of a business that is issuing its shares and other securities to the public in order to raise money. The prospectus is mandatory unless the issuer can find an exemption. In addition, advisers and dealers who trade securities must be registered unless *they* can find an exemption.

Depending on the size of the issuer and the transaction, a prospectus can cost millions of dollars to prepare and publish. Even in relatively small financings, it can cost up to $100,000 – a prohibitive sum for a small business that might otherwise ultimately create significant new jobs and income for the economy by researching, developing and delivering new, innovative technology or by finding new mineral, oil and gas resources.

The new national regime consolidates and harmonizes the various provincial and territorial prospectus and registration exemptions into one single policy, National Instrument 45106 – Prospectus and Registration Exemptions (NI45106). Before NI45106 was implemented, issuers who were making an offering or completing a private placement in several jurisdictions had to comply with different and often inconsistent regimes. Under the new regime, companies are obliged to comply with only one set of rules in all provinces and territories, including Quebec.

In addition, the restrictions on how soon investors may turn around and re-sell the stock they have bought in a private placement have been harmonized. Previously, depending on the jurisdiction, investors were obliged to hold onto the stock they acquired in a private placement for 12 months or longer. Now, in general, the

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Nadim Wakeam is a member of Blaney's corporate/commercial group. His practice involves corporate and securities law, including purchases and sales of businesses, mergers and acquisitions and corporate finance. He holds a joint LL.B./M.B.A. from Osgoode Hall Law School and the Schulich School of Business, York University.

Nadim may be reached directly at 416.593.2980 or nwakeam@blaney.com

hold period across the country is four months and one day. Previously, investors were reluctant to invest in securities that had long hold periods. The new hold period is significantly more palatable to investors and has resulted in a major increase in the number of private placements.

Here are the main exemptions in NI45106 to the prospectus requirement:

Accredited Investor Exemption

This is the most significant exemption harmonized in the new regime. It exempts from registration and prospectus requirements any trade in securities with "accredited investors". The principal categories of accredited investors are:

- Individuals who, either alone or with their spouses, beneficially own, directly or indirectly, financial assets (excluding the value of real property assets) with an aggregate realizable value before taxes, but net of any related liabilities that exceed $1,000,000.
- Individuals, whose net income before taxes exceeded $200,000 in each of the two most recent calendar years or whose net incomes before taxes combined with that of their spouses exceeded $300,000 in each of the two most recent calendar years and who, in either case, *reasonably* expect to exceed that net income level in the current calendar year.
- Individuals who, either alone or with their spouses, have net assets of at least $5,000,000.
- Corporations, other than individuals or investment funds, that have net assets of at least $5,000,000 as shown on their most recently prepared financial statements.
- Companies that are registered or authorized to carry on business as advisers or the equivalent under the securities legislation of a Canadian or foreign jurisdiction and that are acting on behalf of accounts that they manage fully. (In Ontario, the transaction may not involve securities of investment funds.)
- Companies in which all of the owners of interests (except the voting securities required by law to be owned by directors), are persons who are accredited investors.

Private Issuer Exemption

A company is considered a private issuer if its securities are subject to restrictions on transfer and are beneficially owned by not more than 50 persons, not including employees and former employees of the company or its affiliates. The company may only distribute securities to its directors, officers, founders, control persons, family members or accredited investors.

Family, Founders, Control Persons, Friends and Business Associates

This exemption is in force in all provinces and territories except Ontario. It covers sales of a company's securities to persons who are considered to be closely related to the company (e.g. directors, officers, founders, control persons, certain relatives, close personal friends and close business associates). Ontario has adopted its own specific exemption which includes only founders, control persons and family members. In Saskatchewan, issuers have to deliver to authorities an acknowledgement from close personal friends and business associates that they understand the risks involved in the investment.

Minimum amount invested

Prior to NI45106, the exemptions in most jurisdictions were based on minimum investment amounts, often different from one province/territory to the next. NI45106 makes the minimum amount $150,000 throughout the country. So long as investors invest that minimum amount, no registration and prospectus requirements have to be met.

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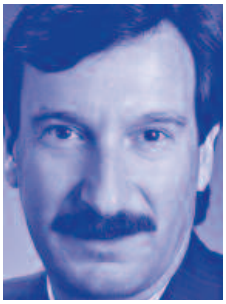

Paul Schnier chairs Blaney McMurtry's tax group. He restricts his practice to income tax law with emphasis on tax planning and implementation and advising as to the tax consequences of proposed transactions. He has advised a variety of public and private corporations on numerous domestic and international undertakings.

Paul may be reached directly at 416.593.3956 or pschnier@blaney.com

Offering Memorandum Exemption
This provides an exemption as long as the investor is given an offering memorandum that complies with the prescribed form and as long as the investor acknowledges the risks associated with investing in the securities. This exemption is not available in Ontario.

Securities for Debt Exemption
This new exemption permits a public company to issue securities to a creditor to settle a *bona fide* debt. This is good news for small issuers who often have cash-flow difficulties and find it useful to issue securities to its creditors to settle debts.

Petroleum, Natural Gas or Mining Properties
This exemption allows a company to pay for petroleum, natural gas or mining properties with its stock. This is a very useful and common exemption for junior exploration companies who need to acquire properties but have limited funds available.

Adoption in Quebec
Quebec has adopted NI45106 in full and this has resulted in significant changes to the exemptions available in that province. Prior to NI45106, issuers had to file a notice with the Autorité des Marchés Financiers (AMF). This often proved expensive and time consuming. Now that Quebec has adopted NI45106, issuers can tap the Quebec market like any other in Canada.

To sum up, then, the implementation of NI45106 has broadened the scope for companies to complete exempt private placements. This is particularly important for junior companies that cannot afford to incur the expense of filing a prospectus. Issuers must prepare only one set of offering and post-closing reporting documents to make a private placement in any province or territory. The significantly shortened hold periods for private placements also improves the ability of junior public companies to attract investors and raise funds.

Large public companies with significant assets have also found it cost effective and expedient to use private placements to finance their ongoing operations. Indeed, the new rules may benefit larger companies more than smaller ones as they are now able to raise large amounts of equity capital at minimal cost.

Although the exemptions set out in NI45106 have been simplified and harmonized, it is important to ensure that you are complying with all of the technical rules associated with qualifying for those exemptions. Issuers should be careful to review the requirements for each exemption to ensure that it applies to the relevant transaction. It is also important to ensure that you prepare the appropriate disclosure documents that comply with the requirements of each exemption in NI45106. Compared to the prior inconsistent and confusing series of exemptions which existed prior to NI45106, the current regime is a huge improvement in the ability of issuers to take advantage of financing opportunities quickly and at lower cost. ■

INCOME TRUSTS – A WHOLE NEW BALLGAME

Paul L. Schnier

Readers may recall that about a year ago then Finance Minister, Ralph Goodale, announced a review of income trusts because these flow through entities ("FTEs") were bleeding the system of corporate tax revenue. His answer was to reduce revenue even further by lowering the tax on dividends from public companies. The current Finance Minister, Jim Flaherty, has taken a somewhat different approach (to put it mildly) in announcing on October 31, 2006 an entirely new regime for the taxation of FTEs. This new regime will become effective January 1, 2007.

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"....Under the proposals, distributions from [income trusts] will be subject to a distribution tax equivalent to the rate of corporate tax that would have applied..."

Here are a couple of basics. Although draft legislation has not yet been released, the Department of Finance has provided some details of the new proposals. The proposed new rules are meant to apply to a clearly defined set of FTEs to be known as "specified investment flow-throughs" or "SIFTs". Without getting into the details, SIFTs will include all of the entities conventionally known as Income Trusts as well as any publicly traded partnerships that hold significant investments in Canadian properties. These rules will apply only to SIFTs that hold "non-portfolio properties" which will include debt or equity of corporations, trusts and partnerships that are resident in Canada as well as Canadian resource properties, timber resource properties and real properties situated in Canada.

Under the current regime, when SIFTs distribute their income, they are entitled to a tax deduction for the amount distributed. Thus, only investors in SIFTs are taxed and many of them pay no or a very low rate of tax on this income. Under the proposals, distributions from SIFTs will be subject to a distribution tax equivalent to the rate of corporate tax that would have applied had this income been earned in a large corporation. In other words, SIFTs will be taxed at the same rate as public companies on the income they distribute to their investors. In addition, distributions from SIFTs will be taxed in the same manner as dividends from public companies subject to the gross up and dividend tax credit. Thus, beginning in 2007, an investment in units of a publicly traded income trust and an investment in shares of a public company will be taxed on exactly the same basis.

Two additional points should be noted. Real estate investment trusts or REITs will not be subject to this new regime. The difference here is that most REITs own their properties directly and would not have otherwise been subject to taxation at the corporate level. Income earned by a REIT will continue to flow through the REIT and be taxed in the hands of the investor. Second, existing SIFTs get a four year grace period. SIFTs that start trading after October 31, 2006 are subject to this new regime beginning January 1, 2007; however, SIFTs that were in existence on October 31, 2006 are subject to this new regime only beginning January 1, 2011. The idea here is to give investors some time to reorganize their holdings.

While we cannot offer any predictions, we think it's safe to say that these new proposals will have a significant effect on the Canadian equity markets. ■

Blaney McMurtry LLP is pleased to announce

Kelly J. Morris, LL.B.

has joined the firm's Corporate Insurance Group.

Kelly brings both law firm and in-house insurance experience to the Blaney's team. She was called to the Bar of Ontario in 1988.

Kelly can be contacted by telephone at 416.596.2898 or by e-mail to kmorris@blaney.com

Blaneys on Business is a publication of the Business Law Department of Blaney McMurtry LLP. The information contained in this newsletter is intended to provide information and comment, in a general fashion, about recent cases and related practice points of interest. The information and views expressed are not intended to provide legal advice. For specific legal advice, please contact us.

We welcome your comments. Address changes, mailing instructions or requests for additional copies should be directed to Chris Jones at 416 593.7221 ext. 3030 or by email to cjones@blaney.com. Legal questions should be addressed to the specified author.

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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

2 Queen St. East, Suite 1500
Toronto, Canada M5C 3G5
416.593.1221 TEL
416.593.5437 FAX
www.blaney.com