
CROSS BORDER SECURITIES UPDATE

October 2005

Inside This Issue:

- **New Prospectus and Registration Exemptions NI 45-106 Effective Sept 14, 2005**
- **Rule Changes from the SEC: New Form 10-QSB; Section 404 Compliance by Non-Accelerated Filers Extended to July 14, 2007**
- **SEC Proposes Amendments to Accelerated Filer Definition and Periodic Reporting Deadlines**

New Prospectus and Registration Exemptions NI 45-106 Effective Sept 14, 2005

The Canadian provinces and territories have adopted National Instrument 45-016 Prospectus and Registration Exemptions (“**NI 45-106**”) which attempts to harmonize some of the more common prospectus and registration exemptions across the country. Not all exemptions, however, have been harmonized. Each Province and Territory has retained a number of its local exemptions which may not have a counterpart anywhere else in Canada. The instrument itself also contains pockets of differences as to how and which exemptions apply in each individual jurisdiction.

The main exemptions you are likely to consider using under NI 45-106 are as follows:

- Private Issuer;
- Accredited Investor;
- Offering Memorandum (not available in Ontario);
- \$150,000 Minimum Investment;

- Family, Friends and Business Associates (not available in Ontario);
- Founder, Control Person and Family (Ontario only exemption);
- Affiliates;
- Employees, Executive Officers, Director, or Consultant; and
- TSX Venture Exchange Offering.

A summary of these exemptions follow. It should be noted there are a number of other exemptions available under 45-106 which have not been included in this article. We strongly recommend you contact legal counsel early when considering conducting a transaction involving the issuance of securities.

Private Issuer Exemption

The Private Issuer exemption allows a company qualifying as a private issuer to offer its securities to:

- directors, officers, employees, founders or control persons of the issuer;
- certain family members, close personal friends and close business associates of a director, executive officer, founder or control person of the issuer;
- a security holder of the issuer;
- an accredited investor; or
- a person that is not a member of the public.

In order to qualify as a Private Issuer, an issuer must:

- not be a reporting issuer or an investment fund;

- place transfer restrictions on its securities (other than non-convertible debt securities) in either its constating documents or security holders’ agreements, and
- have fewer than 50 persons as stockholders (excluding employees and former employees of the issuer or its affiliates), and
- have distributed its securities only to those persons listed above.

No commission or finder’s fee may be paid to any director, officer, founder or control person of an issuer in connection with this exemption (except for sales to an accredited investor).

Accredited Investor Exemption

Securities of any value are permitted to be sold on an exempt basis to accredited investors. An “accredited investor” is defined by their ability to meet certain financial threshold tests and/or their deemed market sophistication to assess the merits of a potential investment. NI 45-106 creates a standard definition across Canada for determining who is an “accredited investor” for the purpose of this exemption. The new definition is a blend of the old definitions of an “accredited investors” found under Ontario Securities Commission Rule 45-501, *Exempt Distributions* (“**OSC Rule 45-501**”) and Multilateral Instrument 45-103, *Capital Raising Exemptions* (“**MI 45-103**”), which was in force in most other jurisdictions other than Ontario and Quebec. Most categories of “accredited investors”

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New Prospectus and Registration Exemptions NI 45-106 Effective Sept 14, 2005 (continued)

under these previous rules were preserved or moved to a new category under NI 45-106 with a couple of exceptions.

The new accredited investor exemption under NI 45-106 offers a number of benefits over its predecessors, as it.

- brings Quebec in line with the rest of Canada by introducing the “accredited investor” exemption to Quebec and eliminating Quebec’s previous “sophisticated purchaser” exemption which was very narrowly defined;
- includes an individual who either alone or with a spouse has new assets (versus “net financial assets”) of at least \$5,00,000 as an accredited investor;
- includes a number of investment funds as accredited investors which were previously excluded;
- includes persons designated by an applicable security regulatory authority as an exempt purchaser in Alberta or British Columbia; and
- it allows fully managed accounts in Ontario to invest in securities of investment funds in reliance on the accredited investor exemption, which is not permitted under previous rule in Ontario;

The exemption is not available to an entity that is created or used solely to purchase or hold securities in reliance on the exemption.

Offering Memorandum Exemption

Ontario has not adopted the offering memorandum exemption. In all other Provinces and Territories, issuers who prepare and deliver an offering memorandum to a purchaser buying securities as principal and obtain a signed risk acknowledgement

statement from that purchases will be exempt from the registration and prospectus requirements.

This exemption does not operate uniformly across Canada.

In British Columbia, New Brunswick, Nova Scotia and Newfoundland there is no minimum or maximum acquisition cost or registered dealer restrictions associated with this exemption.

In Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Quebec and Saskatchewan, purchasers must either be (i) “eligible investors” or (ii) must not acquire more \$10,000 under the offering. An “eligible investor” is defined as an individual with assets in excess of \$400,000, a net income before tax of \$125,000 either alone or together with his or her spouse, or have received advice from an “eligibility advisor” as defined under NI 45-106.

In Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Quebec and Saskatchewan, certain investment funds will be prohibited from relying on the offering memorandum exemption. Only those investment funds which are (a) non-redeemable investment funds, or (b) mutual funds that are (i) reporting issuers, and (ii) in Manitoba, Quebec and Saskatchewan, listed for trading on an exchange or quoted on an over-the-counter market, will be permitted to rely on the exemption.

In New Brunswick, the Northwest Territories, Nunavut and Saskatchewan, no commission or finder’s fee may be paid to any person, other than a registered dealer, in connection with a sale to a purchaser based on the offering memorandum exemption.

The offering memorandum exemption is new to the Province of Quebec and the Yukon Territories.

\$150,000 Minimum Investment Exemption

This exemption replaces the \$97,000 minimum investment exemption in Alberta British Columbia and reintroduces the \$150,000 minimum investment exemption in Ontario. Ontario had originally removed this exemption in 2001 in favour of the accredited investor exemption.

In order to rely on this exemption the purchaser must be purchasing the securities as principal at an acquisition cost of not less than \$150,000, **paid in cash at the time of the trade**, and the trade involves the securities of a single issuer. The exemption is not available to an entity that is created or used solely to purchase or hold securities in reliance on the exemption.

The Alberta and British Columbia Securities Commissions will recognize the previous minimum investment amount of \$97,000 until November 30, 2005.

Family, Friends and Business Associates Exemption (Not available in Ontario)

The Family, Friends and Business Associates Exemption provides an exemption for trades directors, executive officers and control persons of the issuer and certain family members thereof, as well as close personal friends or business associates of a director, executive officer or control person of the issuer or affiliate of the issuer and a founder of the issuer and certain family members of such persons. This exemption is not available in Ontario and is new to Quebec.

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New Prospectus and Registration Exemptions NI 45-106 Effective Sept 14, 2005 (continued)

Founder, Control Person and Family Exemption (Ontario only exemption)

This Ontario exemption, adopted in lieu of the Family, Friends and Business Associate exemption available in the rest of Canada, does not include business associates or close friends. This exemption includes all trades to founder or affiliate of a founder of the issuer or a spouse, parent, brother, sister, grandparent or a child of an executive officer, director or founder of the issuer or a control person of the issuer. These persons were previously included in the definition of "Accredited Investor" in Ontario Securities Commission Rule 45-501 and this exemption has been introduced in Ontario to effectively maintain the status quo of Rule 45-501 in this regard.

Affiliates Exemption

This exemption allows an issuer to trade its securities to an affiliate what is purchasing as principal. An "affiliate" is an issuer with a subsidiary parent relationship to another company or two companies with common control.

Employees, Executive Officers, Director, or Consultant Exemption

This exemption replaces Multilateral Instrument 45-105 – *Trades to Employees, Senior Officers, Directors and Consultants*. NI 45-106 provides exemptions for trades by an issuer or control person to employees, executive officers, directors and consultants of the issuer and related entities if the individual's participation in the trade is voluntary. These individuals may also trade amongst themselves on an exempt basis.

TSX Venture Exchange Offering (Not available in Ontario)

An issuer listed on the TSX Venture Exchange may issue securities on an exempt basis by filing a TSX Venture exchange offering document. This exemption is not available in Ontario.

The full text of NI 45-106 can be found at the British Columbia Securities Commission website: www.bsc.bc.ca

Rule Changes from the SEC: New Form 10-QSB; Section 404 Compliance by Non-Accelerated Filers Extended to July 14, 2007

New Forms 10-K, 10-Q, 10-KSB 10-QSB, or 20-F

A quick reminder that the Securities and Exchange Commission ("SEC") has adopted new filing forms effective Monday, August 22, 2005. The new forms include new text and a check box on the cover page of Forms 10-K, 10-Q, 10-KSB 10-QSB, or 20-F identifying whether or not the registrant is a shell company. The new forms are available on the SEC's website: Corporation Finance: 1934 Act Forms.

The change was undertaken as part of the final rule release entitled "Use of Form S-8, Form 8-K and Form 20-F by Shell Companies" dealing with shell companies, which you can access on the SEC's website at: www.sec.gov/rules/final/33-8587.pdf

Section 404 Compliance by Non-Accelerated Filers Extended to July 14, 2007

The Securities and Exchange Commission announced on September 21, 2005, that it was postponing for one year the date for non-accelerated filers to begin complying

with the disclosure requirements relating to internal control over financial reporting mandated by Section 404 of the Sarbanes-Oxley Act of 2002. As a result, a company that is not an accelerated filer must begin to comply with these requirements beginning with its first fiscal year ending on or after July 15, 2007. This includes foreign private issuers that are not accelerated filers.

Section 404 of the Sarbanes-Oxley Act of 2002 requires, among other things, that:

- a reporting issuer include in its annual report a report of management and an accompanying auditor's report on the effectiveness of an issuer's internal controls; this includes language relating to the maintenance of internal control over financial reporting in the certifications required by Exchange Act Rules 13a-14(a) and 15d-14(a) in the first annual report required to contain management's internal control report and all periodic reports filed thereafter; and
- compliance with the provisions requiring an evaluation of changes to internal control over financial reporting with respect to the company's first periodic report due after the first annual report that must include management's report on internal control over financial reporting.

The compliance dates relating to accelerated filers and registered investment companies are not affected by this extension.

Note: The most recent one-year extension applies to all non-accelerated filers. As a result of recent changes to the definition of accelerated filer (Rule 12b-2), foreign private issuers that file annual reports on Form 20-F or

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Rule Changes from the SEC: New Form 10-QSB; Section 404 Compliance by Non-Accelerated Filers Extended to July 14, 2007 (continued)

40-F will not be entitled to the most recent one-year extension; their internal control reports will be required to be included for reports for fiscal years ending on or after July 15, 2006. A foreign private issuer that is not an accelerated filer must begin to comply in its annual report for its fiscal year ending on or after July 15, 2007.

SEC Proposes Amendments to Accelerated Filer Definition and Periodic Reporting Deadlines

On September 21, 2005, the SEC voted to propose amendments to the periodic filing deadlines and the definition of an "accelerated filer". These proposals would:

- create three filer categories:
 - "Large Accelerated Filers" for issuers with an aggregate worldwide public float of \$700 million or more;
 - "Accelerated Filers" – for issuers with a public float between \$75 million and \$700 million' and
 - "Non-Accelerated Filers" – for those issuers whose public float is below \$75 million.
- provide that the periodic report deadlines for Large Accelerated Filers will be shortened to 60 days for annual reports on Form 10-K for fiscal years ending on or after December 15, 2005, but will remain at 40 days for quarterly reports on Form 10-Q;

- maintain the current periodic report deadlines for Accelerated Filers at 75 days for annual reports on Form 10-K and 40 days for quarterly reports on Form 10-Q; maintain the current periodic report deadlines for Non-Accelerated Filers at 90 days for annual reports on Form 10-K and 45 days on Form 10-Q;
- allow an Accelerated Filers with less than \$25 million in aggregate worldwide public float at the end of its second fiscal quarter to exit Accelerated Filer status at the end of that fiscal year, and allow a large Accelerated Filer with less than \$75 million in worldwide public float at the end of its second fiscal quarter to exit large Accelerated Filer status at the end of that fiscal year.

The actions taken by the SEC were based on recommendations made by the SEC Advisory Committee on Smaller Public Companies.

The SEC's proposed amendments do not affect the filing deadlines of Form 20-F or 40-F of for foreign private issuers.

The information in this newsletter is of a general nature only about recent developments of interest to our clients. You are encouraged to contact legal counsel before acting on any information provided.



Author Alixe Cormick has assisted small and micro cap companies through each stage of their growth from inception to graduation to junior and more senior trading forums.

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