

New Private Placement Rules: Quebec Harmonizes its Rules with the Rest of Canada

By René Branchaud and Sébastien Vézina

A new regime for prospectus and registration exemptions for private placements is now in effect in Quebec. It was developed by the Canadian Securities Administrators (“CSA”) and affects both private and public companies.

In Quebec, the new regime has been implemented in the form of a regulation (“Regulation 45-106”), which has brought about significant changes to both prospectus and registration exemptions under the *Securities Act* (Quebec) (the “Act”).

Regulation 45-106 also introduces several statutory exemptions, which until now, required an application to be filed with the *Autorité des marchés financiers* (“AMF”) (formerly the *Commission des valeurs mobilières du Québec*).

Prior to the introduction of Regulation 45-106, the various provinces of Canada had similar, but not identical, rules for exemptions. Issuers making an offering in several jurisdictions had to comply with a range of acts, regulations and rules. The new harmonized regulation will be applied in all provinces and is expected to reduce the costs incurred by issuers in connection with private placements.

The first part of this bulletin deals with the major exemptions available under Regulation 45-106. The new rules apply to all companies issuing securities either in Quebec or from Quebec.



In addition to introducing new prospectus and registration exemptions, Regulation 45-106 significantly modifies the procedures that an issuer must follow in order to rely on such exemptions. Previously, most exemptions under the Act called for the filing of an application with the AMF before an issuer could distribute its securities in Quebec. Sometimes, the issuer also had to file certain prescribed information or even an offering memorandum with the AMF.

Under the new regime, neither a formal application, information form nor offering memorandum has to be filed prior to the private placement. Instead, in most cases, the issuer simply has to file a notification, along with certain other documents, within a specified period of time following the closing of the private placement. The second part of this bulletin outlines the procedures to be followed in order to take advantage of the exemptions under Regulation 45-106.

It should be noted that the regulations of the various stock exchanges generally require listed companies to file a notification and, in some cases, to obtain the exchange’s prior approval before completing a private placement. These obligations remain in effect and are not changed by the coming into force of Regulation 45-106.

Regulation 45-106 provides for several statutory exemptions that may be relied upon by an issuer looking to raise capital. It also exempts certain business-related operations and commercial transactions, such as reorganizations and asset purchases, from prospectus and registration requirements. Investment funds and certain transactions with the employees and officers of an issuer also benefit from exemptions under Regulation 45-106.

The major exemptions under Regulation 45-106 are set forth below:

The Private Issuer

The exemption previously available to private companies has been replaced by the private issuer exemption. The restriction on making a public offering of its securities has been removed from the definition of a private issuer.

A private issuer is now defined as one whose securities are both subject to restrictions on transfer and are beneficially owned by not more than 50 persons, not including employees and former employees of the issuer or its affiliates. Under Regulation 45-106, such an issuer may distribute its securities to the following persons without the need for a prospectus or registration as a dealer:

- (i) its directors, officers, employees, founders or control person;
- (ii) a spouse, parent, grandparent, brother, sister or child of its directors, executive officers, founders or control person;
- (iii) a parent, grandparent, brother, sister or child of the spouse of a director, executive officer, founder or control person;
- (iv) a close personal friend of a director, executive officer, founder or control person;



- (v) a close business associate of a director, executive officer, founder or control person;
- (vi) its security holders;
- (vii) accredited investors; or
- (viii) a person that is not a member of the public.

These clearly defined criteria now permit a private issuer to better identify the persons it may solicit to raise capital. Moreover, the pool of persons that can be solicited has been extended and even includes accredited investors.

As regards the definition of “a person that is not a member of the public”, the CSA have indicated that they will use the tests that have been established under case law to determine whether or not a person is a member of the public. These jurisprudential tests include the “need to know” test and “common bonds of interest or association” test.

Under the “need to know” test, the Courts have determined that persons who do not require the type of information contained in a prospectus, due to the fact that they already have access to this information, are not members of the public. The Courts have also ruled that, under the “common bonds of interest or association” test, certain persons cannot be considered members of the public. These tests have been strictly applied by the Courts.

The Accredited Investor

This exemption was already available as of right in most Canadian provinces, with the notable exception of Quebec. However, from now on, an issuer looking to raise capital in Quebec will be able to rely on this exemption without having to obtain the AMF’s prior approval.

The accredited investor must be acting as principal and is defined as, among other things:

- (i) an individual who, either alone or with a spouse, owns financial assets having an aggregate realizable value that, before taxes, but net of any related liabilities, exceeds \$1,000,000;
- (ii) an individual whose net income before taxes, in each of the two most recent calendar years, as well as in the current calendar year, exceeds \$200,000 or, when combined with that of a spouse, exceeds \$300,000;
- (iii) an individual who, either alone or with a spouse, has net assets of at least \$5,000,000;
- (iv) a person, other than an individual or investment fund, that has net assets of at least \$5,000,000;
- (v) a corporation whose shareholders are all accredited investors; or
- (vi) an individual registered as an advisor or dealer under the securities legislation of a jurisdiction of Canada.

Family, Friends and Business Associates

A distribution of securities to certain persons who are “close” to the issuer is also exempt from prospectus and registration requirements. Persons considered “close” to the issuer include:

- (i) a director, executive officer, founder or control person of the issuer or of an affiliate of the issuer;
- (ii) a spouse, parent, grandparent, brother, sister or child of the persons named in (i) above or of a spouse of such persons;

- (iii) a close personal friend or close business associate of the persons named in (i) above; or

- (iv) a person of which a majority of the voting securities are beneficially owned by the persons named in (i) to (iii) above.

Determining whether someone is a “close personal friend” or a “close business associate” will be based on the particular circumstances of each case. Essentially, the close personal friend and the close business associate must be familiar enough with the director, executive officer, founder or control person, so as to be able to appreciate his skills and loyalty.

Minimum Investment of \$150,000

As was the case before, even where an investor does not qualify as an accredited investor, family member, friend or business associate, he can still purchase securities under an exempt distribution, provided that he purchases the securities as principal and the acquisition cost of the securities is not less than \$150,000.

Offering Memorandum

The qualification criteria regarding distributions by way of an offering memorandum have also been relaxed, with the number of purchasers no longer being limited and the issuer no longer being required to confer a tax advantage upon the purchaser. In addition, the offering memorandum no longer needs to be filed with the AMF in advance of the distribution in order to rely on this exemption.

From now on, an issuer that distributes its securities by way of an offering memorandum may distribute its securities to investors who act as principals and qualify as eligible investors, or where the aggregate acquisition cost of such securities to the purchaser does not exceed \$10,000, provided the investor signs a risk acknowledgement in the required form.

An investor qualifies as an eligible investor if, among other things:

- (i) his net assets, alone or combined with those of a spouse, exceed \$400,000;
- (ii) his net income before taxes, in each of the 2 most recent calendar years, as well as in the current calendar year, exceeded \$75,000 alone or, combined with that of a spouse, exceeded \$125,000;
- (iii) he is an accredited investor; or
- (iv) he is a family member, close personal friend or close business associate (as defined above) of the issuer.

Business Combinations, Reorganizations and Commercial Transactions

An issuer may now rely on a statutory exemption in connection with:

- (i) a trade in securities of the issuer in the context of an amalgamation, merger, reorganization or arrangement that is described in an information circular and is approved by the security holders whose approval is required;
- (ii) a trade in securities of the issuer in connection with a dissolution or winding-up of the issuer;
- (iii) the issuance of securities by the issuer as consideration for assets having a fair value of not less than \$150,000;
- (iv) the issuance of securities by the issuer as consideration for the acquisition of petroleum, natural gas or mining properties or any interest in them;
- (v) the issuance of securities by a reporting issuer to a creditor to settle a *bona fide* debt.

Employees, Executive Officers, Directors and Consultants

An issuer whose securities are listed on an organized stock exchange may distribute securities of its own issue to an employee, executive officer, director or consultant without the need for a prospectus or registration as a dealer, if participation in the trade is voluntary.

In the case of a reporting issuer whose shares are not listed on a stock exchange, certain requirements must be met for the exemption to apply (shareholders' approval, maximum number of securities that may be issued, maximum term, etc.).

Offerings by TSX Venture Exchange Short Form Offering Document

The prospectus requirement does not apply to offerings made in accordance with TSX Venture Exchange Policy 4.6-Public Offering by Short Form Offering Document, provided the issuer has filed an annual information form and is a reporting issuer in at least one Canadian jurisdiction. To rely on this exemption, the issuer must file a short form offering document with the securities regulatory authority in those jurisdictions where it is a reporting issuer.

The advantage of this type of financing is that the securities purchased may be freely traded, with the exception of securities purchased by an insider, promoter, agent or underwriter of the issuer or by a purchaser who purchases securities in an amount exceeding \$40,000.

The offering document prepared by the issuer, as well as the conditions of the offering, must comply not only with the policy of the TSX Venture Exchange, but also with Regulation 45-106.

As with a short form prospectus, the offering document incorporates certain continuous disclosure documents by reference, including the issuer's annual information form and financial statements.

Resale of Securities Acquired in Connection with an Exempt Distribution

In most cases, there are restrictions on the resale of securities that are issued under an exemption. As was the case under the old rules, a four-month hold period generally applies, except where the issuer is a private issuer.

Filing Requirements

The filing requirements under Regulation 45-106 have been made easier and more efficient. Reporting and filing requirements have now been harmonized throughout Canada. An issuer, other than a private issuer, that distributes securities under certain of the exemptions in Regulation 45-106 is typically required to file a report of exempt distribution, the form of which is prescribed by regulation.

Such report basically includes the following information:

- the name, address and industry of the issuer;
- the total number and type of securities distributed;
- the Canadian and foreign jurisdictions where investors reside; and
- the name and address of any person who has received or will receive compensation in connection with the distribution.

The issuer must ensure that it obtains the consent required under the legislation regarding the protection of personal information, including an authorization of indirect collection of personal information for distributions in Ontario. In general, the subscription agreement should contain a statement from the purchaser to that effect.

A duly authorized representative of the issuer must certify that the information contained in the report is true by means of a signed certificate to be filed within 10 days of the distribution.

Each province and territory will charge filing fees which should be similar to those charged prior to the advent of Regulation 45-106.

Conclusion

The new Regulation 45-106 simplifies and harmonizes prospectus and registration exemptions throughout Canada, as well as related reporting and filing requirements.

Over the next few months, issuers should seek advice from their legal counsel in order to carefully plan their financing strategy. Issuers will want to take full advantage of this reform, while ensuring that they prepare disclosure documents that comply with the new regulation. The new rules will reduce your operating costs since you will no longer have to devote as much time to complying with the confusing array of exemptions and filing requirements that used to exist in the various jurisdictions across Canada.

You can contact any of the following members of the Securities Law group in relation to this bulletin.

At our Montréal office

Michel Blouin
514 877-3041
mblouin@lavery.qc.ca

René Branchaud
514 877-3040
rbranchaud@lavery.qc.ca

Georges Dubé
514 877-2989
gdube@lavery.qc.ca

Isabelle Lamarre
514 877-2995
ilamarre@lavery.qc.ca

André Laurin
514 877-2987
alaurin@lavery.qc.ca

Larry Markowitz
514 877-3048
lmarkowitz@lavery.qc.ca

Jean Martel
514 877-2969
jmartel@lavery.qc.ca

Michel Servant
514 877-2915
mservant@lavery.qc.ca

Sébastien Vézina
514 877-2964
svezina@lavery.qc.ca

Montreal
Suite 4000
1 Place Ville Marie
Montreal, Quebec
H3B 4M4

Telephone:
514 871-1522
Fax:
514 871-8977

Quebec City
Suite 500
925 chemin Saint-Louis
Quebec City, Quebec
G1S 1C1

Telephone:
418 688-5000
Fax:
418 688-3458

Laval
Suite 500
3080 boul. Le Carrefour
Laval, Quebec
H7T 2R5

Telephone:
450 978-8100
Fax:
450 978-8111

Ottawa
Suite 1810
360 Albert Street
Ottawa, Ontario
K1R 7X7

Telephone:
613 594-4936
Fax:
613 594-8783

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