

Allen & Allen Update on Securities Law

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Enacted:

OSC Increases Continuous Disclosure Reviews

The Ontario Securities Commission is building up its Continuous Disclosure Team to ensure that all of the largest 100 TSX companies that are headquartered in Ontario are reviewed this year. The OSC is committing additional resources, on a temporary basis, to carry out a thorough and timely review of 44 major companies that have not been reviewed by securities regulators in the normal course of reviews carried out in the past year.

Only normal course bids during takeover bid to be permitted, under Ontario Rules - In force

Rule 62-501 and amended Policy 62-601 came into force on August 2, 2002. They restrict the circumstances under which an offeror making a take-over bid is permitted, during the course of the bid, to acquire securities of the class for which the bid is made, otherwise than pursuant to the bid itself.

Commodity pools now have specialized mutual fund rule - National - In Force

Multilateral Instrument 81-104 for Commodity Pools is now in force in all jurisdictions, except Quebec. However, the British Columbia Commission did not adopt some sections dealing with the rules for establishing new commodity pools, the proficiency requirements that apply to dealers in British Columbia selling securities of commodity pools in that province, and certain of the commodity pool prospectus and continuous disclosure requirements. The Instrument operates to allow commodity pools to follow investment objectives and strategies that may involve investing in commodities (either directly or through the use of derivatives), using derivatives and employing leverage in ways not permitted for conventional mutual funds. The specialized rules of the Instrument are intended to reflect the different investment objectives and risk profile of commodity pools when compared with mutual funds regulated by NI 81-102.

Proposed:

Harmonized exemptions proposed in most jurisdictions, except Ontario and Quebec

Most jurisdictions except Ontario and Quebec are publishing for comment Multilateral Instrument 45-103 - "Capital Raising Exemptions", the substance of which already comprises a rule in British Columbia and Alberta. MI 45-103 would provide three generally harmonized exemptions as follows:

- "Private issuer" exemption;
- "Family, friends and business associates" exemption;
- "Accredited investor" exemption - paralleling the exemption in Ontario Rule 45-501; and
- Three variations of an "Offering memorandum" exemption.

Differences in the Offering Memorandum exemption would relate to whether a purchaser must meet eligibility criteria. In British Columbia and Nova Scotia, any purchaser could invest under the exemption. In Alberta and Manitoba, any purchaser could invest up to \$10,000; however, to invest more than \$10,000 the purchaser must be an "eligible investor", which generally refers to a purchaser meeting certain financial tests (eg. \$75,000 pre-tax net income or \$400,000 net assets) or has obtained advice regarding the suitability of the investment from a registered investment dealer or, in Saskatchewan or Manitoba, a specified lawyer or accountant. In each of Newfoundland and Labrador, Northwest Territories, Nunavut, Prince Edward Island and Saskatchewan, every purchaser must be an "eligible investor" regardless of the amount invested. In each of Saskatchewan, Northwest Territories and Nunavut, the total amount that could be raised under the offering memorandum exemption would be \$1 million.

Currently, all these jurisdictions also have a minimum acquisition cost exemption - either \$97,000 or \$150,000 (not Ontario, which has repealed the \$150,000 exemption) . If it is decided to retain the exemption, it would be harmonized.

Proposed Multilateral Instrument 45-103. Comments are due November 19, 2002

Trades to Employees, Senior Officers, Directors and Consultants to be harmonized - proposed National Rule 45-105

The Securities Regulators in all jurisdictions except Quebec are proposing a harmonized Rule 45-105 for trades to Employees, Senior Officers, Directors, and Consultants.

Section 2.1 contains basic dealer registration and prospectus exemptions for trades by an issuer in securities of the issuer's own issue to (a) an employee, senior officer, director, or consultant of the issuer or of an affiliated entity of the issuer; (b) a trustee, custodian, or administrator acting on behalf, or for the benefit, of a person or company referred to in paragraph (a); (c) a holding entity of an individual referred to in paragraph (a); (d) an RRSP or RRIF of an individual referred to in paragraph (a); (e) the spouse of an individual referred to in paragraph (a); or (f) an RRSP or RRIF of the spouse of an individual referred to in paragraph (a); provided participation in the trade by the employee, senior officer, or consultant referred to in paragraph (a) is voluntary.

If an issuer is not a "listed issuer", in certain cases, the exemptions in section 2.1 are not available for a trade to certain investor relations persons, associated consultants, senior officers or directors (or their trustees, custodians, etc) unless prior shareholder approval has been obtained. This restriction will not apply in British Columbia.

Section 2.2 provides dealer registration and prospectus exemptions for trades from current or former employees, senior officers, directors, and consultants to current employees, senior officers, directors, and consultants. However, these exemptions are only available where: (a) the participation in the trade of the employee, the consultant, or the senior officer to whom the trade is made is voluntary, (b) the issuer of the security is not a reporting issuer in any jurisdiction of Canada, and (c) the price of the security being traded is established by a generally applicable formula contained in a written agreement among some or all of the shareholders of the issuer to which the transferee is or will become a party.

Section 2.3 provides dealer registration and prospectus exemptions for trades that are, or are incidental to, the issuance of securities upon the exercise of an exchange or conversion right that was originally distributed under the exemption in section 2.1.

Section 2.4 provides dealer registration and prospectus exemptions for trades in securities acquired under section 2.1, 2.2 or 2.3 between an employee, senior officer, director, or consultant and a trustee, custodian or administrator acting on their behalf, their holding entity, their RRSP or RRIF, their spouse or an RRSP or RRIF of their spouse.

Part 3 of the Proposed Instrument sets out resale restrictions.

Comments are due January 30, 2003.

New Oil & Gas Disclosure Standards to be Applied in 2004, says Alberta Commission

Compliance with new disclosure standards for oil and gas reserves reporting will not be mandatory for financial years ending before December 31, 2003, say Alberta Securities Commission staff.

In a Notice published on September 27, 2002, ASC staff announced that they and their counterparts among the Canadian Securities Administrators are still in the process of considering National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities published in January 2002 in light of public comments received.

Enhanced disclosure proposed for all Investment Funds - National

The Canadian Securities Administrators (CSA) are publishing for comment proposed rules that would require investment funds to provide more timely and useful financial and non-financial information to investors and advisers. The rules would apply to all investment funds, including mutual funds, labour sponsored investment funds, exchange traded funds, split share corporations, closed end funds and scholarship plans.

The key features of the proposed rules are: (i) annual and quarterly management reports of fund performance, including an analysis of past performance and the strategic position of the fund; (ii) the revision and updating of requirements relating to annual and interim financial statements, with a consistent set of rules across Canada; and (iii) changes to current filing and delivery requirements, allowing security holders to choose whether to receive any or all of a fund's statements and reports.

Proposed National Instrument 81-106 Comments are due by December 19, 2002.

OSC “Fair Dealing Model” would focus on relationships rather products and transactions

The OSC has proposed a new approach to regulate the relationship between investors and advisers. The “Fair Dealing Model” would focus on relationships rather than on products and transactions. Three basic relationships are described:

- The “Managed-For-You” relationship puts primary responsibility on the adviser. Investors surrender control of their accounts to expert managers, who do not consult with them trade-by-trade. The managers have a trustee level of fiduciary duty, and are responsible for deep knowledge of their clients and their circumstances. Compensation is typically fee-based.
- The “Advisory Relationship” shares responsibility between the adviser and investor. Both parties must agree to all trades. The adviser has a responsibility to educate the client about investment basics, to learn the client’s needs, resources and tolerance for uncertain outcomes. The investor has a responsibility to provide adequate information to the adviser. There can be a variety of ways the adviser is compensated, subject to mutual agreement.
- The “Self-Managed” relationship puts primary responsibility on the investor. Investors take complete responsibility for all trades and the impact on their portfolios. The provider has no responsibility to know the client’s circumstances or align investment decisions with tolerance for uncertainty. But the adviser is required to be truthful, to reveal potential biases in the information it provides, to make its compensation structure transparent and to stand behind the technical reliability of the trading technology and tools it may offer.

Under the Fair Dealing Model, an advisor can only have one type of relationship with a client at one time, but an investor could have different relationships with different advisors, to benefit from differing investment strategies.

To solicit feedback, the OSC has illustrated these three adviser relationships in a flashy new web site, at: www.fairdealingmodel.com. Comments are requested by December 31, 2002

New rule-making power to the OSC regarding audits and disclosure controls, under proposed Ontario legislation

Ontario has proposed legislation that would:

- Increase power to the OSC to review the information that public companies disclose to investors;
- Grant the OSC new rule-making power regarding audit committees, systems of internal controls, disclosure controls and procedures, requiring chief executive officers and chief financial officers to provide certifications, and rules for defining auditing standards for reporting on internal controls. Such powers would allow the OSC to impose strict rules similar to the U.S. Sarbanes-Oxley Act of 2002 - summarized below.

Bill 198, First Reading, October 30, 2002

Ontario Commission examining U.S. style reforms

In an open letter to Ontario market participants, OSC Chair David Brown referred to the importance of maintaining domestic and international confidence in Ontario markets, the “spillover effect in Canada from the damage to investor confidence in the U.S.”, and the ongoing dialogue with the U.S. Securities Exchange Commission regarding cross-border issues and substantial compliance with the U.S. Sarbanes-Oxley Act of 2002.

Mr. Brown noted that in the year ended March 31, 2002, the OSC Continuous Disclosure team reviewed nearly 30 per cent of Ontario-based reporting issuers, of which 23 per cent agreed to enhance their future disclosure practices, and 9 per cent were required to refile certain materials due to deficiencies in their original filings. Although the TSX, and others, have suggested that many of the fundamental changes to audit committees should be in the form of voluntary guidelines with a requirement for companies to disclose whether they are in compliance with the guidelines, Mr. Brown noted that, in 1999, members of the Dey Committee observed that “although significant improvement had occurred in the quality of governance of Canadian corporations, the response of Canadian corporations to the governance initiatives was more formal than substantive and the corporate sector in Canada had not yet achieved a ‘culture of compliance’”.

OSC staff are exploring the adoption of requirements similar to the U.S. Sarbanes-Oxley Act of 2002. The new US rules require, for example: (1) prohibiting auditors from performing non-audit services for the issuer while acting as its auditor, including bookkeeping or other services, unless pre-approved by the audit committee and disclosed in public filings; (2) rotating the lead audit partner every five years; (3) prohibiting those who accept any consulting, advisory, or other compensatory fee from acting on the audit committee; (4) requiring the CEO and CFO to maintain internal controls, and to certify each annual and quarterly report; (5) forfeiting certain bonuses and profits should an issuer be required to prepare certain accounting restatements; (6) enhanced disclosure in periodic reports; (7) enhanced conflict of interest provisions; and (8) stiffer penalties for securities offences and fraud.

Issuers who are required to restate financial statements will be posted on OSC web site

The OSC will be posting on its web site a list of issuers subject to “Refilings and Corrections of Errors”. These are issuers that are required to restate and refile financial statements; issuers that implement accounting changes in their financial statements on a retroactive basis, where such an accounting change represents the correction of an error in the financial information as originally filed; and issuers which amend and refile other continuous disclosure documents. The list will show the name of the issuer, the date of refiling, a short description of the deficiency identified, and a link to the issuer's description of the change. Issuers will be kept on the list for a minimum of three years. The list will only include issuers whose deficiency was identified in a review since October 25, 2002, pursuant to the OSC continuous disclosure review program. However, the OSC is considering expanding the list to include restatements arising outside of a staff review under the OSC continuous disclosure review program.

In addition, it is the OSC's view that investors should be informed immediately of a refiling, or a retroactive accounting change, by way of a news release; and, if the change is material, the filing of a material change report with the OSC in accordance with section 75 of the Act. Notice 51-709

Ontario proposes new enforcement powers under Securities Act

The Ontario government has proposed legislation that would:

- Increase maximum penalties for Securities Act offences to a fine of \$5 million and imprisonment for five years less a day;
- New administrative powers to the Ontario Securities Commission to order penalties of up to \$1 million and to order disgorgement of amounts obtained as a result of non-compliance.

- A new prohibition from engaging in acts that a person or company knows, or reasonably ought to know, perpetrate a fraud or result in a misleading appearance of trading activity in, or an artificial price for, a security. The amendments would also contain a general prohibition from making statements that a person or company knows, or reasonably ought to know, are misleading or untrue and significantly affect, or would reasonably be expected to have a significant effect on, the market price or value of a security.

Bill 198, First Reading, October 30, 2002

Civil liability in the secondary market under proposed Ontario legislation

The Ontario government has proposed legislation that would include:

- New civil liability for secondary market disclosure. Specified transactions would be exempt.
- New rights of action, including a right of action for damages by persons or companies who acquire or dispose of the securities of a responsible issuer (being a reporting issuer, or any other publicly traded issuer with a substantial connection to Ontario) during a period of time in which there is an uncorrected misrepresentation in a document released by the responsible issuer or by a person with actual, implied or apparent authority, or in a public oral statement by such a person or by an influential person (a defined expression) relating to the affairs of the responsible issuer.
- The right of action would be given to persons or companies acquiring or disposing of the securities of the responsible issuer between the time the misrepresentation was made and the time it was publicly corrected.
- There would also be a right of action for damages by persons or companies who acquire or dispose of an issuer's security during a period in which a responsible issuer fails to make a timely disclosure of a material change. The period ends when the responsible issuer makes the required disclosure.
- These rights of action lie against specified persons and companies in the circumstances described in the section: (1) the responsible issuer; (2) the person making the public oral statement; (3) each director or officer of the responsible issuer; (4) an influential person; (5) each director or officer of the influential person; and (6) each expert (a defined word).

Bill 198, First Reading, October 30, 2002

BC Commission Chair cautions against rush to U.S. style reforms

B.C. Securities Commission Chair Doug Hyndman warned against rushing to adopt U.S.-style securities regulatory reforms in an October breakfast speech at the Economic Club of Toronto.

"Canadian regulators would do a serious disservice to Canadian markets and investors if we adopt more rules just to keep pace with our neighbours," said Hyndman. "Our duty is to regulate the markets under our jurisdiction as efficiently and effectively as we can. We should pay attention to what is happening in the U.S. and elsewhere but we shouldn't adopt new rules just for the sake of harmonization."

Hyndman said that rather than adopting more prescriptive and detailed rules, Canadian investors would be better protected from the accounting fraud, governance lapses, and other market abuses that have been revealed in the U.S. by having regulators do a better job of enforcing the current rules already in place.

"This is probably the worst time for us to adopt prescriptive requirements for governance," he said. "As a result of the train wrecks of the past year, investors are now taking governance more seriously and asking companies hard questions about what their directors are doing. We should let the market work, as only it can, rather than stepping in as if we had all the answers."

Please call if you have any questions - 416-865-0303

ALLEN AND ALLEN

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JOHN ALLEN: A graduate of law from Queen's University, John was called to the Bar in 1991, clerked with the Ontario Superior Court, and has a Masters of Law in securities law from Osgoode Hall. He is a graduate of the "Canadian Securities Course", "Financial Planning Course", and has all academic requirements for the designation of Certified Financial Planner (CFP). He is also the author of a monthly securities "Netletter" available only on Quicklaw (www.quicklaw.com), a fee-based legal database service.