

Allen & Allen Update on Securities Law

www.virtual-law.com

September 1st 2004

Enacted:

CNQ recognized as a Stock Exchange by Ontario Commission

On May 7, 2004, the Ontario Commission recognized the Canadian Trading and Quotation System (CNQ) as a stock exchange (thus revoking the February 28, 2003 order recognizing CNQ as a quotation and reporting system). To reflect the change, the Commission also approved minor amendments to CNQ's rules, policies and forms.

As a result of the change, reporting issuers or equivalents in good standing in any Canadian jurisdiction can apply and be listed on CNQ without first making application to the OSC to become an Ontario reporting issuer. As well, CNQ listed issuers that were not Ontario reporting issuers have automatically become Ontario reporting issuers and must make the appropriate filings with the OSC.

Sponsorship of an Issuer – TSX to expand exemptions

The TSX Venture Exchange has applied to the Alberta and British Columbia Securities Commissions to expand and clarify the circumstances in which the Exchange may exercise its discretion to waive the requirement for sponsorship.

Sponsorship involves the documented due diligence review of an Issuer's business by a Member or Participating Organization. Sponsorship is required by the Exchange in connection with certain new listings, including an initial listing (excluding an IPO undertaken pursuant to a prospectus offering), a Reverse Take-over, a Change of Business and a Qualifying Transaction.

Currently, the Exchange may exercise its discretion to waive sponsorship where:

- the Issuer is a domestic resource Issuer that will meet Tier 2 Minimum Listing Requirements, management of the Issuer satisfies certain high management standards and the Issuer has a current Geological Report for each of the Issuer's Qualifying and Principal Properties; or
- the Exchange considers that the granting of an exemption would not be contrary to the public interest.

In addition, the Exchange will also consider exercising discretion to waive sponsorship requirements where:

- the Issuer submits a completed Transaction Disclosure Form; and either:
 - there is significant involvement of a bank or other major financial institution in the transaction; or
 - the issuer conducts a concurrent brokered financing of at least \$500,000 in connection with the transaction, and the agent for that transaction has provided the Exchange with confirmation that it has completed appropriate due diligence on both the transaction and the disclosure document; and
- a disclosure document is prepared in conjunction with the transaction, containing at a minimum, the information required in an offering memorandum or pursuant to Exchange Requirements.

TSX Notice to Issuers, July 8th 2004

Harmonized Continuous Disclosure Review Program

Staff of the Canadian Securities Administrators (“CSA”) have established a program of harmonized continuous disclosure review, which is being adopted in British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, Québec and Nova Scotia. Staff will generally follow principles of mutual reliance similar to the principles that underlie the mutual reliance review systems for applications for exemptive relief, and for prospectuses and annual information forms. It is expected that issuers will deal only with staff of a principal regulator, and that staff of the non-principal regulators will rely on the staff of the principal regulator on such matters.

CSA Staff Notice 51-312

Proposed:

Exemption from Certain Insider Reporting Requirements - Proposed - National

The Canadian Securities Administrators (CSA) are publishing for comment revised National Instrument 55-101 and its related Policy - "Exemption from Certain Insider Reporting Requirements". The most significant changes to the Current Instrument are as follows:

(a) Senior officers of a reporting issuer, or a subsidiary of a reporting issuer, who meet the following criteria would be exempt from the insider reporting requirements (the non-executive officer exemption):

- an individual not in charge of a principal business unit, division or function of the reporting issuer or a major subsidiary of the reporting issuer;
- an individual who does not in the ordinary course receive or have access to information as to material facts or material changes concerning the reporting issuer before the material facts or material changes are generally disclosed; and
- an individual who is not an insider of the reporting issuer in any other capacity.

(b) The current requirement to prepare and maintain a list of insiders exempted from the insider reporting requirement would be supplemented with an additional list of insiders who are not exempted. As an alternative, a reporting issuer may file an undertaking with the regulator that it will make available to the regulator, promptly upon request, a list containing the information.

(c) A new requirement would be imposed requiring reporting issuers to prepare and maintain reasonable policies and procedures relating to monitoring and restricting the trading activities of its insiders and other persons with access to material undisclosed information relating to the reporting issuer or to an investment issuer of the reporting issuer.

(d) The existing exemption in the Current Instrument relating to acquisitions of securities pursuant to an "automatic securities purchase plan" has been amended to include an exemption for certain dispositions of securities that commonly occur in connection with a plan, and that may be reported on an annual basis (the specified disposition amendment).

(e) The existing exemption relating to acquisitions of securities pursuant to an "automatic securities purchase plan" has also been amended to provide that the alternative reporting requirement that allows for a consolidated report to be filed within 90 days of the end of the calendar year does not apply if, at the time the alternative report becomes due, the individual has ceased to be subject to an insider reporting requirement (the alternative report amendment).

BC publishes for comment new Rules for new Securities Act

The new BC Securities Act (Bill 38) received Royal Assent on May 13th 2004 and will come into force on Proclamation, expected for the fall of 2004. The Commission is publishing for comment related instruments, including the general Securities Rules and rules for Takeover Bids and Issuer Bids (62-502), Exemptions for Foreign Market Participants (71-502), Mutual Fund Requirements 81-509 and Exemptions from Periodic Disclosure Requirements for Non-Redeemable Investment Funds (81-510).

New "interface" exemptions are being proposed that would generally allow market participants to satisfy BC requirements by complying with the requirements of another province and filing in BC.

Under the Continuous Market Access system ("CMA"), a public issuer whose continuous disclosure record is up to date and includes a current annual information form (AIF) would be able to issue securities without filing a prospectus. The issuer would file a new release disclosing the offering and the relevant details. No hold periods would apply. This exemption would not be available for multi-jurisdictional offerings.

The valuation requirement for insider bids, issuer bids and going private transactions would be removed. According to the BC Commission, valuations are often unnecessary, but when they are, directors routinely obtain opinions from independent and qualified valuers when not required by securities laws, in order to ensure they discharge their duties as directors.

In addition, the proposed Rules would:

- replace current “prescriptive and arbitrary” capital and bonding requirements with a sufficiency test tied to the firm's business model and potential risks (SRO members would continue to follow SRO requirements)
- impose outcomes based record-keeping requirements and a requirement to retain records for 6 years and communications with clients for 3 years
- provide a new exemption for institutional financial derivatives sold by Canadian financial institutions or registered dealers
- incorporate audit committee and corporate governance requirements consistent with those the BCSC recently published for comment (BCNs 2004/19 and 2004/28)
- require delivery of offering documents and continuous disclosure documents to investors on request
- require a public issuer to file annually a list of its insiders
- impose plain language requirements for all information provided to investors or clients
- require all filings with the Commission to be electronic

BC Notice 2004/31

Legislative Priorities for OSC

Four legislative initiatives have been given priority by the Ontario Securities Commission Chair David Brown, in response to the Five Year Review Committee report:

- The need to proclaim amendments to the Securities Act that would create a regime for statutory civil liability for secondary market disclosure, and add express prohibitions against fraud, market manipulation and misrepresentation.
- The need for better tools and flexibility to deal effectively with securities regulators in other Canadian jurisdictions, including statutory amendments to facilitate inter-jurisdictional delegation of decision-making
- The need to reduce the regulatory burden and facilitate quick responses to new situations by allowing the Commission to issue blanket rulings and orders that provide exemptive relief to market participants.
- The need to catch up to changes in how commercial law deals with the transfer and pledging of securities. This is an area where Canada lags the U.S. and the European Union.

Real Estate Securities - Special form of offering memorandum – Alberta Rule Proposed

For “real estate securities”, effective September 15, 2004, the Alberta Securities Commission will require a special form of offering memorandum, if securities are being distributed under the offering memorandum exemption in Multilateral Instrument 45-103.

Alberta Rule 45-509, and its Companion Policy, defines “real estate security” as having three components:

1. the real estate security is an investment contract
 - a. If the issuer is offering another type of security, for example a common share of a company engaged in the real estate business, then it is not a “real estate security”,
 - b. The definition of “real estate project” is intentionally broad to capture a wide range of real estate projects – for example, from undeveloped land development to an operating condominiumized hotel.
2. the purchaser’s economic entitlement under the investment contract is to a material extent attributable to a real estate project, and
3. the occupation or use by the purchaser of the real property that is the subject of the real estate project is prohibited or materially restricted.

The disclosure requires that:

- Real estate values be supported by independent appraisals in accordance with the standards of the Appraisal Institute of Canada
- future-oriented financial information (FOFI) must be audited, and the offering memorandum must be updated in there is a material change in the FOFI, and the issuer must annually file and send to the purchaser a comparison of the FOFI to the actual results for the same period.

This Rule comes into force on September 15, 2004.

The Alberta Capital Market: Exempt Market Study

The Alberta Securities Commission has issued a report entitled "The Alberta Capital Market: Exempt Market Study". It found a significant (103%) increase in the amount of capital raised in the exempt market by Alberta-based issuers in 2003 compared to the same period in 2002.

- There was an increase in the percentage of capital being raised by small and medium sized issuers using the new MI 45-103 exemptions
- The new accredited investor exemption was used significantly more than the old \$97,000 exemption during both test periods.
- Accredited investors invested considerably smaller amounts per investment; however, there was more usage of the exemption and therefore significantly more money raised.
- This increase was not caused by general market conditions, because a review of the Equity Financings Summaries of the TSX Venture Exchange showed an aggregate public financing in 2002 of roughly \$83 million and the exempt financing in 2002 of roughly \$82 million. In 2003, public financing decreased to approximately \$70 million and exempt financings increased to almost \$167 million.

Forecasts in a prospectus - the Danier case at trial

On May 20, 1998, Danier completed an IPO of 6,040,000 subordinate voting shares at \$11.25 per share, for total gross proceeds of \$67,950,000. The Prospectus contained a forecast of financial results for the fourth quarter of 1998 and for the fiscal year ending June 27, 1998. On June 4, 1998, two weeks after the IPO closed, Danier issued a press release entitled "Danier Revises Fiscal 1998 Forecast", in which Danier announced that it had revised its forecast for its fourth quarter and 1998 fiscal year downward. The press release stated that the "unseasonably warm weather in most of its markets" was the cause of the revision and that the revised forecast anticipated that "recent warm weather trends will continue in June, impacting leather apparel sales and profits." The revised forecast differed significantly from the forecast in the prospectus.

The trial judge held that, although a forecast is not a fact in the sense that actual results are facts, the factual assertions that may be derived from a forecast is a representation that: (i.) the forecaster's best judgment of the most probable set of economic conditions and the company's planned course of action; (ii.) the forecast is sound and reliable in the sense that the forecaster made it with reasonable care and skill; and (iii.) the forecaster generally believes the forecast, the forecaster's belief is

reasonable and the forecaster is not aware of any undisclosed facts tending to seriously undermine the accuracy of the forecast.

A forecast is untrue if management subjectively does not believe the forecast. The forecast is also untrue if management subjectively believes the forecast, but objectively there is no reasonable basis for this belief.

The trial judge held that, as of May 20, 1998, the Forecast was misleading in the light of the circumstances in which the Forecast was made, and certain of the factual assertions implied from the Forecast were untrue. Disclosure of the intra-Q4 1998 results was necessary to make the Forecast not misleading.

The cautionary language in the prospectus did not shield liability: It was the standard cautionary language required by National Policy 48. The risk factors did not specifically relate to the Forecast. No mention was made in the cautions, assumptions or risk factors of the impact that weather may have on Danier's sales, a factor which was clearly significant and was the specific risk that led to the adverse intra-quarter results and the revised forecast.

Kerr v. Danier Leather Inc. [2004] O.J. No. 1916

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

ALLEN AND ALLEN

WILLIAM ALLEN: A graduate of the University of Toronto, Bill was called to the Bar in 1954. He later obtained a Masters of Law (LL.M.) from Osgoode Hall. He has lectured for the Canadian Bar Association and the Law Society of Upper Canada. He is the author of the Estate Planning Handbook (with three editions, published in 1985, 1991 and 1999) and has worked in the area of securities law since the early 1960s.

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.