

WHAT EVERY BUSINESS OWNER MUST KNOW ABOUT SECURITIES

FALL 2010



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There is a common misconception that securities laws only apply to incorporated companies listed on stock exchanges. Actually, securities laws apply to all issuers from the moment of their incorporation or formation. Forming an organization usually involves issuing securities to the owners or founders. Securities regulations specify how these securities can be issued.

The misconception that securities laws only apply to public companies results in many start-up and early stage issuers unintentionally breaking the law. Securities are broadly defined and include shares, options, debentures, notes, other instruments of indebtedness, limited partnership units and memberships in co-operative associations, for example. If you are a director, senior officer or owner of any issuer at its early stage of development, you will inevitably engage in the issuing of securities.

When securities are issued, the issuer must file a prospectus with the Securities Commission, unless a prospectus exemption exists. A prospectus is a comprehensive document that discloses all material information about the issuer and the securities being sold. This requirement ensures that investors have the information to make an informed investment decision.

The Securities Commission has recognized that certain classes of investors do not need the same level of protection as the general public. Accordingly, there are a number of exemptions to the prospectus requirements for companies selling securities to the exempt classes of investors. You can use these exemptions to create your organization, reward your employees, raise money to finance the development of your business, and reorganize or sell your business.

PRIVATE ISSUERS

For many small corporations, one of the more common exemptions will be the private issuer exemption. A private issuer must have less than 50 securityholders and must have restrictions on the transfer of its securities,

other than non-convertible debt securities. It also cannot be a reporting issuer, which is generally an issuer that has filed a prospectus or has been declared to be a reporting issuer by the Securities Commission.

By using the above exemption, a private issuer can raise capital by selling securities to a limited class of investors listed in National Instrument 45-106 (available at: <http://www.albertasecurities.com/securitiesLaw/Pages/InstrumentsPolicies.aspx>). The exempt classes include directors or officers of the issuer, their family members or accredited investors.

WHAT ABOUT NON-PRIVATE ISSUERS?

A number of other exemptions are available to issuers who do not fit the private issuer definition. These provide issuers and purchasers with additional flexibility to trade securities.

FAMILY, FRIENDS AND BUSINESS ASSOCIATES EXEMPTION

Under this exemption, an issuer can sell securities in any amount without providing any disclosure to a defined class of individuals. These include directors and executive officers of the issuer, their family members, or close personal friends and business associates. Note that close personal friend and close business associate are strictly defined terms in Companion Policy 45-106CP, and the Securities Commission may require evidence that those individuals have sufficiently close ties to the issuer.

ACCREDITED INVESTOR & \$150,000 EXEMPTION

Accredited investors include individuals with at least \$1 million in financial assets before taxes, or whose net income before taxes exceeds \$200,000 in each of the two most recent years and who reasonably expect to exceed that net income in the current year. Corporations with at least \$5 million in net assets, or whose owners are all accredited investors themselves, also meet the definition of an accredited investor. Under the \$150,000 exemption, you can sell securities to anyone without providing any disclosure, provided the purchaser buys at least \$150,000 worth of securities, paid in cash at the time of closing.

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EMPLOYEE, DIRECTOR, OFFICER AND CONSULTANT EXEMPTION

Under this exemption, an issuer can sell securities in any amount without providing any disclosure to its employees, directors, senior officers or consultants, provided the purchaser is buying the security “voluntarily” (as defined in NI 45-106).

OFFERING MEMORANDUM EXEMPTION

Under this exemption, a company may raise money from investors by providing those investors with relevant information through a document called an offering memorandum. Only an issuer selling its own securities can rely on this exemption. The offering memorandum describes the company and the securities being sold, and attaches audited financial statements of the company. The securities laws also require the purchaser to sign a Risk Acknowledgment Form, with which the purchaser acknowledges that it is entering into a risky investment.

RESALE RESTRICTIONS

If you issue or sell securities using any of the exemptions listed in this material, the securities are subject to resale restrictions. This means that the purchaser cannot resell the securities unless certain requirements are met. This includes not selling the securities for a specific hold period. However, to resell their securities, purchasers can rely on any of the exemptions listed in this material, except for the employee, director, officer and consultant exemption and the offering memorandum exemption (which are only available to issuers when issuing their securities).

FILING REQUIREMENTS

With the exception of the private issuer exemption and the employee, director, officer, and consultant exemption, each time an issuer uses any of the exemptions discussed above, the issuer must file with the Securities Commission - on or before the 10th day after the distribution - a report of the exempt distribution using Form 45-106F1. Additionally, if an issuer uses the offering memorandum exemption, it must file with the Commission a copy of the offering memorandum on or before the 10th day after the distribution. National Instrument 45-106, which sets out the Prospectus and Registration Exemptions in more detail, can be accessed at: www.albertasecurities.com.

Securities laws are complex and apply more often than business owners recognize. Certain securities distributions will require issuers to provide purchasers with detailed information about the issuer and the securities being sold, unless they fit solidly within one of the exemptions listed in 45-106. The exemptions contain important limitations and definitions; therefore, an issuer should seek professional advice to ensure that it is compliant and is availing itself of the best possible option. This article is intended for general information only, and must not be relied upon as legal advice.

DISCLAIMER

This article should not be interpreted as providing legal advice. Consult your legal adviser before acting on any of the information contained in it. Questions, comments, suggestions and address updates are most appreciated and should be directed to:

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