Access To Capital For Small And Medium-Sized Businesses — ASC Adopts New Capital-Raising Initiatives For Start-Up Businesses

September 19, 2016

The Alberta Securities Commission (ASC) has adopted ASC Rule 45-517 *Prospectus Exemption for Start-Up Businesses* (Start-Up Exemption) which came into effect July 19, 2016. The Start-Up Exemption is a prospectus exemption intended to allow Alberta-based small and start-up issuers to raise modest amounts of capital. The Start-Up Exemption can be found here.

Additionally, on **July 26, 2016**, the ASC published for a 30-day comment period Multilateral Instrument 45-108 *Crowdfunding* (Online Crowdfunding Exemption). The Online Crowdfunding Exemption is a prospectus exemption designed to enable moderate financing across multiple Canadian jurisdictions via an online funding portal registered as either a "registered dealer funding portal" or a "restricted dealer funding portal". The Online Crowdfunding Exemption has already been adopted in Saskatchewan, Manitoba, Ontario, Quebec, New Brunswick and Nova Scotia effective January 25, 2016. The Online Crowdfunding Exemption can be found here.

Start-Up Exemption Highlights

- **Availability** — available to an issuer that is not an investment fund or a reporting issuer and is not subject to reporting obligations in a foreign jurisdiction similar to those of a reporting issuer. The head office of the issuer must be located in Alberta or a jurisdiction in Canada that has adopted a corresponding exemption. An issuer can raise money using other prospectus exemptions concurrently with a Start-Up Exemption distribution.
- **Type of Security** — each security distributed must be an "eligible security" which means any of the following:
  (i) a common share;
  (ii) a non-convertible preference share;
  (iii) a security convertible into (a) or (b);
  (iv) a non-convertible debt security linked to a fixed or floating interest rate;
  (v) a limited partnership unit; or
  (vi) an investment share that is a non-convertible preference share issued by a cooperative organized under the *Cooperatives Act* (Alberta).

- **Method** — funds can be raised through:
  (i) an online funding portal (provided that the portal is compliant with registration requirements) or other more traditional revenue sourcing avenues;
  (ii) a dealer (provided that the dealer is compliant with registration requirements) that will solicit investment and distribute securities through traditional distribution channels; or
  (iii) the issuer's principal's own network of contacts (provided that they are not in the business of trading securities such that the dealer registration requirement is triggered). Additionally, no commission or fee or other amounts can be paid to the issuer group[1], or any principals, employees or agents thereof.
- **Distribution Limit** — a maximum of two distributions with an aggregate limit of $250,000 in a calendar year. A "lifetime limit" also applies such that the aggregate funds raised by the issuer group through all Start-Up Exemption distributions must be less than $1,000,000.
- **Investment Limits** — if a registered dealer is not involved in the distribution, no investor can invest more than $1,500 in a single investment up to a maximum of $3,000 per issuer group in the same calendar year under all Start-Up Exemption distributions.
- **No Registration Exemption** — the Start-Up Exemption does not provide an exemption from the requirement that a person or company who is a dealer must be registered. A person or company acting as a dealer in respect of a distribution of securities under the Start-Up Exemption is required to comply with registration requirements.
- **Offering Document & Subscription Requirements** — to rely on the Start - Up Exemption, issuers must provide to investors an offering document in the form of Form 45-517F1 *Start-up Business Offering Document* and must obtain a signed risk acknowledgment from each investor prior to the investor signing the agreement to purchase the securities. The risk acknowledgment must be in the form prescribed by Form 45-109F2 *Start-up Business Risk Acknowledgment*. The issuer must also provide the investor the right to withdraw the offer to purchase the security within 48 hours of the later of the investor's subscription and an amended offering document being delivered to the investor.
- **Filing Requirements** — within 30 days after the closing of any distribution under the Start-Up Exemption, the issuer must file with the ASC a completed report of exempt distribution in the form of Form 45-106F1 *Report of Exempt Distribution*, together with the offering document, including all applicable amendments. The report of exempt distribution and offering document must be filed electronically through the System for Electronic Document and Analysis and Retrieval (SEDAR) in accordance with National Instrument 13-101 *System for Electronic Document Analysis and Retrieval (SEDAR)*.
- **Implications** — an issuer that relies on the Start-Up Exemption:
  (i) may no longer be considered a "private issuer" under NI 45-106 and will be unable to rely on the "private issuer" prospectus exemption for future distributions of securities. Losing access to the private issuer exemption may deter potential issuers from relying on the Start-Up Exemption;
  (ii) may have an unusually large number of minority shareholders which would increase costs associated with shareholder meetings and communications with shareholders; and
  (iii) these investment limits per investor are potentially problematic as the issuer will need to locate a fairly large number of investors to raise the maximum amount and the compliance costs associated with each subscription could be significant relative to the amount of funds that can be raised.

Online Crowdfunding Exemption Highlights

- **Availability** — available to reporting issuers and non-reporting issuers provided that the issuer:
  (i) is organized in a jurisdiction in Canada;
  (ii) has its head office in Canada;
  (iii) has a board of directors comprised of a majority of Canadian residents; and
  (iv) is not an investment fund.
- **Type of Security** — the same parameters that apply to the Start-Up Exemption apply to the Online Crowdfunding Exemption with the exception that flow-through shares under the *Income Tax Act* (Canada) are permissible for distribution pursuant to the Online Crowdfunding Exemption whereas investment shares that are non-convertible preference shares issued by a cooperative organized under the *Cooperatives Act* (Alberta) are not.
- **Method** — funds must be raised through a single funding portal that is registered as either a "registered dealer funding portal" or a "restricted dealer funding portal". Both restricted dealer funding portals and registered dealer funding portals will be subject to additional requirements imposed by the Online Crowdfunding Exemption that will require dealers to provide certain "gatekeeper" functions aimed at investor protection and issuer monitoring. Additionally, the funding portal:
  (i) must not advertise a distribution or solicit purchasers under the Online Crowdfunding Exemption;
  (ii) may only make available to purchasers: the crowdfunding document, a term sheet, a video, and other materials summarizing the information in the crowdfunding document; and
  (iii) must ensure that the information about the issuer and a distribution of securities of the issuer is presented or displayed on its online platform in a fair, balanced and reasonable manner.
- **Distribution Limit** — up to $1,500,000 within a calendar year, subject to certain limitations including:
  (i) the Online Crowdfunding Exemption is not available if the proceeds are being used to invest in, merge with, or acquire an unspecified business;
  (ii) the Online Crowdfunding Exemption is not available if the issuer is in default of its ongoing disclosure obligations;
  (iii) the offering cannot remain open for more than 90 days and the offering cannot close if the minimum subscription has not been raised; and
  (iv) the offering document must disclose the minimum offering size and whether there is a maximum offering size.
- **Investment Limits**
  (i) non-accredited investors – maximum of $2,500 per distribution and $10,000 per calendar year for all distributions under the Online Crowdfunding Exemption; and
  (ii) accredited investors – maximum of $25,000 per distribution and $50,000 per calendar year in all distributions under the Online Crowdfunding Exemption; and
  (iii) permitted clients (as such term is defined in National Instrument 31-103 *Registration Requirements, Exemptions and Ongoing Registrant Obligations*) – no limit.

  Finally, no person or company in the issuer group or director or executive officer of an issuer in the issuer group may directly or indirectly lend or finance, or

arrange lending or financing for a purchaser to purchase securities of the issuer under the Online Crowdfunding Exemption

- **Offering Document & Subscription Requirements** — in order to rely on the Online Crowdfunding Exemption, issuers are responsible for preparing and providing to investors the offering document. Financial statements are required as part of the offering document and are subject to the following requirements:
  (i) to be approved be management where the issuer raises no more than $250,000 under any prospectus exemptions;
  (ii) to be approved by management and accompanied by a review report where the issuer has raised between $250,000 and $750,000 under any prospectus exemption; and
  (iii) to be approved by management and accompanied by an auditor's report where the issuer has raised more than $750,000 under any prospectus exemption.

In the event of a reporting issuer, the offering document must also include a two-day right of withdrawal at the option of the investor and in the event of a misrepresentation, the right of action for damages or rescission. In the event of a non-reporting issuer, the offering document must include a contractual right of action against the issuer for rescission and damages in the event of an untrue statement of a material fact included in any of the materials made available to the purchaser. Additionally, investors retain a right to withdraw their purchase within 48 hours of purchase and subsequent to any amendment to the offering document. Finally, in the event of a reporting issuer, securities distributed are subject to a four-month hold period and if a non-reporting issuer, to an indefinite hold period and can only be resold under another prospectus exemption.

The issuer must additionally obtain a signed risk acknowledgment from each investor prior to the investor signing the agreement to purchase the securities requiring them to positively confirm having read and understood the risk warnings and information in the crowdfunding offering document. The risk acknowledgement must be in the form prescribed by the proposed Form 45-108F2 *Risk Acknowledgment*. The issuer must additionally obtain an investment limit form in the form of 45-108F3 *Confirmation of Investment Limits* whereby the investor confirms how he, she, or it qualifies to buy securities under the Online Crowdfunding Exemption.

- **Filing Requirements** – within 10 days after the closing of any distribution under the Online Crowdfunding Exemption, the issuer must file through SEDAR a completed report of exempt distribution with the ASC in the form of Form 45-106F1 *Report of Exempt Distribution*, the offering document, and a term sheet as well as any other materials summarizing the information in the offering document if applicable. Upon request, the issuer may also be required to deliver to the securities regulator a video relating to the distribution, if access to such a video has been provided to investors.
- **Implications** – in the event that the Online Crowdfunding Exemption is adopted as a new rule in Alberta, the Start-Up Exemption will be amended to allow a distribution under the Start-Up Exemption to be facilitated by a restricted dealer funding portal complying with specified requirements of the Online Crowdfunding Exemption.

Going Forward

Both the Start-Up Exemption and the Online Crowdfunding Exemption would allow issuers who may not have access to capital from accredited investors to access smaller amounts of capital from a wider range of persons. It remains to be seen whether these exemptions can be utilized in a cost-efficient manner, and whether, under the Start-Up Exemption, issuers will be willing to surrender access to the private issuer exemption in favour of this new exemption.

Please call the authors of this Bulletin or your usual lawyer in BLG's Securities and Capital Markets Group to discuss the Start-Up Exemption or the Online Crowdfunding Exemption and the potential for your business to raise capital using these exemptions.

[1] "issuer group" means an issuer together with each of the following:

- each affiliate of the issuer;
- each other issuer that is either of the following:
  - that is engaged in a common enterprise with the issuer or with an affiliate of the issuer;
  - that has a founder that is a founder of the issuer.

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