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# INSIDE

## THE LAW

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## Changes to Ontario's Business Law Regime May Be Coming Soon

By Zev Zlotnick, T: 416.865.6601, zzlotnick@gardiner-roberts.com

**A**s the electronic age revolutionizes global commerce, the business and legal frameworks supporting this transformation in Ontario are badly in need of an upgrade. While other international legal communities are already adapting to the needs of their financial and business counterparts, Ontario's corporate legal framework is antiquating itself by procrastinating amendments to its deficient commercial law. Recently, Ontario's Minister of Consumer and Business Services told an audience of lawyers that the first phase of changes will be proposed, starting in the fall of 2005.

Consumer and Business Services Minister Jim Watson, speaking at a May 2005 Ontario Bar Association conference, says revisions to the province's business regime will come in three phases. This fall, he said the first phase will begin with proposed amendments to securities transfer laws.

The second phase of proposed amendments, likely in 2006, will focus



on the Business Corporations Act (Ontario) (OBCA). And, the third phase is expected to focus on the Corporations Act - specifically as it

*Continued bottom of page 3*

## Growing Demand for Unlimited Liability Corporations in Ontario

By Catherine Carscallen, T: 416.865.6654, ccarscallen@gardiner-roberts.com

**T**he Business Corporations Act (Ontario) (OBCA) is being targeted in the business and legal communities for immediate reform if the province is to enhance its competitive position as a "business-friendly" jurisdiction within Canada and globally. Integral to this reform is proposed legislation allowing the formation of unlimited liability companies.

Unlimited liability corporations would allow U.S. investors to take advantage of U.S. tax benefits when making large-dollar investments in Canada. It would also allow Ontario

to maintain or, arguably regain, its position as the leading financial and commercial jurisdiction in Canada and the principal point of entry for foreign investment and trade.

The Second Submission on Ontario ULC Legislation by the Ontario Bar Association (Business Law Section, Corporate Law

*Continued bottom of page 2*

### ALSO INSIDE

Changes to Ontario's Business Law Regime May Be Coming Soon .....	1
Increasing Demands for Unlimited Liability Corporations in Ontario .....	1
Private Placement Exemptions for Ontario's Market Participants to be Amended Again .....	2
New Privacy Concerns in Business Purchases and Sales .....	6
New Limitations Act Ignores Commercial Reality .....	7
Gardiner Roberts News .....	8

Inside

# Private Placement Exemptions for Ontario's Market Participants to be Amended Again

By Peter Moffatt, T: 416.865.6604, pmoffatt@gardiner-roberts.com

**T**he implementation of National Instrument 45-106 – **Prospective and Registration Exemptions (NI 45-106)** is intended to consolidate and harmonize the many prospectus and registration exemptions set out in various provincial statutes and national, multilateral and local instruments into a single national instrument. It is intended that NI 45-106 will reduce transaction costs for market participants. As noted below, however, NI 45-106 in its current form falls well short of full harmonization, particularly as it applies in Ontario. As at the date of this article, the final form of NI 45-106 is not yet published though it is expected that it will be released by Canadian Securities Administrators shortly.

Market participants in Ontario will recall this is the second major overhaul of private placement exemptions in the province in the last five years. In November 2001, the closely held issuer and accredited investor exemptions were introduced to replace the private company/ private issuer exemptions, seed capital exemption and sophisticated purchaser exemption.

## Capital Raising Exemptions Available

- *Accredited Investor Exemption:* Prospectus and registration requirements do not apply to a trade in a security to a purchaser if that purchaser buys the security as principal and is an “accredited investor”. Every jurisdiction other than Ontario includes as an “accredited investor” a person acting on behalf of a fully managed account and registered as an adviser in a foreign jurisdiction. In Ontario, a person acting on behalf of a fully managed account must be registered as an adviser in a jurisdiction of Canada.
- *Private Issuer Exemption:* Prospectus and registration requirements do not apply to a trade in a security of a private issuer to a person who purchases the security as principal and is among a defined group of persons related in some way to the issuer (such as directors, officers, employees, founders and control persons, certain relatives, close personal friends, close

### *Continued from page 1*

pertains to charities and not-for-profits. It should be noted that the government has made no formal announcement of this three-phase plan. That said, here are some legislative amendments members of the legal community are lobbying for.

### **Ratify Uniform Securities Transfer Act (USTA)**

This is legislation that has been encouraged by many financial and legal entities in Ontario. The OBCA, in particular the sections on Investment Securities, need to conform to the USTA, thereby ensuring

the promptness and efficiency of processing, safe-holding and transferring securities in a multi-jurisdictional setting. In addition, the OBCA needs to be amended to clarify the indirect holding system in terms of settlement of trades and security entitlements when intermediaries are used.

### **Residency Requirements for Directors**

As corporate development proliferates, internationalized organizations are seeking more educated and experienced individuals to lead these new-aged global companies. The OBCA residency requirements for directors and

committee members restrict Ontario-based companies from accessing the available supply of international leadership. The rules requiring a majority of Ontario-based directors should be repealed.

### **Federal-Provincial Harmonization**

In 2001, the federal government enacted significant legislative changes to the Canadian Business Corporations Act (CBCA). The amendments modernized Canadian law to conform to contemporary issues, such as governance and shareholders rights.

The CBCA has acclimatized to cor-



business associates of such persons, accredited investors, persons who are not members of the public, etc.). A private issuer is defined as an issuer:

- (i) That is not a reporting issuer,
  - (ii) Whose securities are subject to restrictions on transfer contained in the issuer's constating documents and are beneficially owned, directly or indirectly, by not more than 50 persons (exclusive of employees and former employees of the issuer), and
  - (iii) That has distributed securities only to the defined group of persons above. No commission or finder's fee may be paid to any director, officer, founder or control person of an issuer in connection with a trade under this exemption (except a trade to an accredited investor). The private issuer exemption replaces the closely held issuer exemption currently available under Current Rule 45-501.
- *Family, Friends and Business Associates Exemption:* Prospectus and registration requirements do not apply to a trade in a security to a purchaser if the purchaser buys the security as principal and is among a defined

group of persons related in some way to the issuer (such as directors, executive officers and control persons and certain relatives, close personal friends and close business associates of such persons). No commission or finder's fee may be paid to any director, officer, founder or control person of an issuer in connection with a trade under this exemption. In Ontario, a more limited Family, Founder and Control Person exemption is available only to founders, affiliates of founders, certain relatives of executive officers, directors, or founders and control persons.

- *Offering Memorandum Exemption:* Prospectus and registration requirements do not apply to a trade by an issuer in a security of its own issue to a purchaser if the purchaser buys the security as principal and the issuer (i) delivers an offering memorandum in prescribed form to the purchaser and (ii) obtains a risk acknowledgment in prescribed form from the purchaser. In Alberta, Manitoba, Northwest Territories, Nunavut, Prince Edward Island, Quebec and Saskatchewan, the purchaser must also be an "eligible investor" or the purchaser's acquisition cost must not exceed \$10,000. Ontario is not adopting the offering memorandum exemption.

*Continued bottom of page 5*

porate governance concerns by redefining the roles of directors and officers - specifically, delineating conflict of interest parameters, indemnification and insurance conditions, and allowing for limiting of liability through the adoption of charter provisions.

Directors and officers would be more willing to operate in Ontario if the OBCA were to adopt similar regulations. As well, to maximize shareholder effectiveness, the OBCA should adopt the enhanced CBCA regimes for shareholder proposals and proxy solicitation and, like the CBCA, modernize its rules

for electronic shareholder communications and virtual shareholder meetings.

In addition, adapting shareholder voting entitlements to National Instrument 54-101 would simplify the communication flow between reporting issuers and shareholders.

#### **Unanimous Shareholder Agreements**

To support the proliferation of privately held companies, the OBCA should facilitate improved control mechanisms by which small businesses can control their companies by standardizing and enhancing the unanimous shareholder agreement

provisions.

For example, the unanimous shareholder system should not be required when appointing a board of directors for a private company. A standardized, unambiguous system will allow for self-administration, cost-savings and the expeditious conformity to the OBCA rules.

#### **Miscellaneous Changes**

The CBCA has also abolished rules relating to financial assistance by a corporation. The OBCA should do the same.

Finally, the OBCA should allow lower tier corporations to hold shares of upper tier corporations. ◆

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Subcommittee), dated November 2004, recommends the OBCA be amended, among other things, to permit the formation of unlimited liability corporations.

### **What is a ULC?**

Currently, the OBCA does not permit the formation of an unlimited liability corporation (ULC). Pursuant to the OBCA, shareholders of a corporation are not liable for the debts and liabilities of the corporation (subject to certain enumerated exceptions) and, therefore, are considered to have limited liability.

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## *The ULC is a form of corporation that provides foreign investors with flexibility for U.S. tax purposes.*

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In contrast to shareholders of a "limited corporation" (the only type of corporation now permitted by the OBCA), shareholders of a ULC would, upon a liquidation event, become liable for the debts and liabilities of the ULC.

According to the proposed amendments in the OBA Submission, a "liquidation event" would essentially mean the bankruptcy, liquidation, dissolution or winding-up of a ULC (as opposed to a financial reorganization or reconstruction meant to salvage and resurrect the business of the corporation).

### **Why is a ULC Attractive to Foreign Investors?**

The rationale for allowing the ULC as a form of corporation is to provide foreign investors with flexibility in choosing a vehicle that, for U.S. tax purposes, can elect to be treated as a corporation or as a "disregarded non-corporate entity" (either as a partnership, if it has two or more members, or as a branch operation, if it has only one member). If "disregarded treatment" applies, certain U.S. tax advantages may result, including:

- Losses of the ULC may be flowed through and applied against profits of the U.S. shareholder;
- In takeovers of Canadian companies, the Canadian vendor will be taxed under the Income Tax Act on

the basis of a sale of shares, while the U.S. purchaser will be taxed under the U.S. Internal Revenue Code on the basis that it has acquired assets; and

- Facilitated availability of foreign tax credits by the U.S. shareholder.

The flow-through treatment of the ULC is attractive for direct investment from U.S. investors and from non-U.S. foreign investors who invest in Canada via the U.S.

### **No Canadian Tax Advantage or Disadvantage**

The ULC has no current appeal or tax advantages for purely domestic investors. The tax advantages of a ULC are all U.S. tax advantages.

Regardless of the treatment that a ULC may receive under the U.S. Code, it is still treated as a "Canadian corporation" for Canadian income tax purposes. As a result, there is no loss of Canadian tax revenue from allowing the formation of a ULC as a vehicle for direct foreign investment in Canada from the U.S.

### **Nova Scotia ULCs**

Nova Scotia was the first jurisdiction in Canada to permit, under its Companies Act (NSCA), the formation of a ULC that is eligible to elect to be treated as a "disregarded entity" under the U.S. Code.

According to the OBA Submission, the use of ULCs in Nova Scotia over the past decade or so has shown they have become the preferred vehicle for large-dollar direct investment from the U.S. into Canada due to the potential for favorable U.S. tax advantages. This is despite the fact that Nova Scotia currently charges an annual incorporation tax of \$4,000 and annual filing fee of \$2,000 for each ULC.

### **Alberta ULCs**

As of May 2005, Alberta became the second jurisdiction in Canada to permit, under its Business Corporations Act (Alberta) (ABCA), the incorporation of unlimited liability corporations. Alberta's ULCs are expected to be very popular and it is thought that many Nova Scotia ULCs will convert themselves by continuing under the ABCA. Alberta's relatively low tax rates and the high administrative and incorporation fees charged under the N.S. law are expected to fuel demand. The ABCA is also a more modern statute and closely modeled to U.S. styles of business incorporations.

### Advantages to Ontario ULCs

The OBA Submission suggests the ULC could most often be used for transactions based in Ontario and would offer significant advantages to foreign investors in comparison to a Nova Scotia ULC (NSULC). For instance:

- Foreign investors would be able to simplify corporate structures and operational affairs by removing the need to structure their transactions through another jurisdiction (e.g., Nova Scotia) which likely has little or no connection to the Canadian operations or the place where the particular transaction - be it an acquisition, divestiture, financing, corporate reorganization or other event - is being run.
- By removing an additional layer of complexity and an additional jurisdiction, foreign investors may be able to avoid or reduce certain expenses and transaction costs, including costs of retaining lawyers in multiple jurisdictions.

In many respects, the OBCA is a more attractive, modern corporate statute than the NSCA. For instance, the OBCA is indirectly modeled on certain U.S. corporate statutes and uses concepts and terminology with which U.S. investors and their legal counsel would generally be familiar. Also, some corporate procedures (such as shareholder meetings, amalgamations, arrangements, reorganizations and minority squeeze-outs) are much simpler

under the OBCA than under the NSCA or are absent from the NSCA altogether (which is a securities transfer regime).

### Summary

The OBA Submission illustrates how Ontario could easily provide for ULCs through a rather modest set of amendments to the OBCA. By amending the OBCA to allow for the formation of ULCs as an alternative to NSULCs, Ontario has an opportunity to overcome many technical deficiencies that have been identified in the NSCA.

The OBA Submission also identifies certain desirable but optional amendments to the OBCA which would serve to create a more efficient corporate regime overall and enhance the status of the OBCA as a leading corporate law statute.

The adoption of ULC legislation in Ontario would be a welcome event as it would provide foreign investors with an attractive alternative to NSULCs and an efficient corporate regime to attract and facilitate foreign investment in Ontario and the rest of Canada.

The amendment of the OBCA to allow for ULCs, in conjunction with other proposed amendments to the OBCA, should be part of Ontario's strategy to keep its laws competitive by national and international standards. It would also signal that Ontario, the financial and commercial capital of Canada, is open for business and, in particular, for foreign investment. ◆

### Continued from page 3

- *Minimum Amount Investment Exemption:* Prospectus and registration requirements do not apply to a trade in a security if the purchaser buys as principal and the security has an acquisition cost of not less than \$150,000 paid in cash at the time of the trade.
- *Employee, Executive Officer, Director and Consultant Exemptions:* Exemptions currently available under Multilateral

Instrument 45-105 - Trades to Employees, Senior Officers, Directors and Consultants have been consolidated into NI 45-106 with some minor modifications.

- *Incorporation or Organization Exemption:* Prospectus and registration requirements do not apply to a trade by an issuer in a security of its own issue if the trade is reasonably necessary to facilitate the incorporation or organization of the issuer, and the securities are traded for nominal consideration

to not more than five incorporators or organizers.

### Reporting Requirements

The use of certain exemptions triggers the requirement to file a Form 45-106F1, which is a report of exempt distribution (that is, accredited investor exemption and minimum amount investment exemption). Form 45-106F1 does not require a vendor that is not an issuer to file a report of exempt distribution. This is a change from current reporting requirements in Ontario. ◆

## New Privacy Concerns in Business Purchases and Sales

By Nelson DasNeves, T: 416.865.6691, [ndneves@gardiner-roberts.com](mailto:ndneves@gardiner-roberts.com)

**S**ince January 1, 2004, every “organization” that collects, uses or discloses “personal information” in the course of commercial activities has had to comply with the Personal Information Protection and Electronic Documents Act (PIPEDA). Since then, it has become apparent that every organization is now well advised to seek compliance before engaging in any potential purchase-and-sale transaction.

Compliance with PIPEDA requires that, among other things, an organization must not collect, use or disclose personal information without the individual's knowledge and consent (subject to limited exceptions).

Generally, “personal information” is information, whether factual or subjective, about an identifiable individual. Personal information does not include the name, title, business address or telephone number of an employee of an organization.

### Purchase and Sale Transactions

Setting aside the fact that compliance with PIPEDA is

mandatory, every organization would be well advised to achieve compliance in their organization ahead of any potential purchase-and-sale transaction to avoid delays that would inevitably arise.

Although privacy concerns should not directly arise in most share-purchase transactions - since a transfer or assignment of personal information is not taking place and, typically, the holder of the personal information or target company remains the same - a prudent purchaser would want to ensure a vendor is compliant with PIPEDA to avoid unwanted liabilities. And, an eager vendor would want to ensure there is compliance to increase its transaction value or avoid any decrease.

Compliance issues will normally arise in a purchase-and-sale transaction involving the assets of a business. In these transactions, the parties will first need to determine whether personal information is being transferred or disclosed as part of the transaction.

## New Limitations Act Ignores Commercial Reality

By Stephen Thiele, T: 416.865.6651, [sthiele@gardiner-roberts.com](mailto:sthiele@gardiner-roberts.com)

**O**n January 1, 2004, a new law came into force in Ontario that significantly changes the limitation period within which litigants must launch a lawsuit.

Generally, under the new Limitations Act, 2002, the well-known and familiar six-year limitation period for contract and tort claims has been reduced to just two years. In addition, an ultimate limitation period of 15 years has been introduced. Limitation periods under the old regime are preserved for certain claims under transition provisions. Limitation periods related to real property

claims are generally unaltered.

Although the new Act is viewed as improving the law, since the number of exceptions to the basic limitation periods have been eliminated, it is having a significant impact on the commercial community.

### Who Is Affected?

Lenders, in particular, have been required to pay attention to the new Act since the reduction in the basic limitation period requires them to renew things such as on demand promissory notes within two years rather than six years.

For commercial transactions, lawyers are perplexed by a provision contained in s. 22 of the new Act that prohibits parties from contracting out of the limitation periods contained in the Act. According to many lawyers, this provision does not reflect commercial reality.

Although intense lobbying efforts have so far failed to convince the government to amend s. 22, it is my understanding that draft amendments are currently being circulated that would once again restore commercial reality to the limitations regime.



If so, the knowledge and consent of each individual affected will be required before completion of the transaction.

The Act does not specify the form of consent (i.e., express or implied) to be used in each instance. It has been suggested by the Privacy Commissioner of Canada (PCC) that express (that is, written) consent is the preferred method.

Ideally, the vendor in an asset transaction will have already obtained the consent of each individual as part of its compliance process, in which case the purchaser should easily be able to obtain representations and warranties in this regard. If, however, the vendor has not been compliant with PIPEDA or is in the process of attaining compliance, obtaining the consent of each individual will be required.

One method of protecting the purchaser is to obtain a covenant from the vendor that it will comply with PIPEDA prior to closing. This may not, however, be possible due to the expense and time requirements involved. As such, the purchaser will need to explore other options, such as obtaining an indemnity from

the vendor for any claims that result from the vendor's non-compliance.

Whether a cap is placed on the indemnity is a matter of negotiation, but the amount is not easily quantifiable as the range of penalties and remedies available to the PCC to pursue breaches of PIPEDA are broad.

At the end of the day, the level of compliance that is required of a vendor will likely be determined by the level of risk the purchaser is willing to assume or an adjustment in the purchase price.

It is important to note the obligation to deal with PIPEDA and, more importantly, with obtaining the consent of individuals extends to the due diligence process. A vendor would be well advised to obtain the consent of each individual to the disclosure of personal information in such circumstances (this should be set out in an organization's privacy policy and its standard form of consent).

The vendor will also want to enter into a confidentiality agreement with the potential purchaser - one that effectively deals with the collection, use and disclosure of personal information only for such purposes. ◆

However until any amendments are made, parties involved in commercial transactions are required to obey the prohibition.

### **Any Chance to Avoid the Prohibition?**

Creative lawyers have considered a number of schemes to avoid the

under the new Act, commercial lawyers will be unable to assure clients that provisions that shorten or extend limitation periods will actually be enforceable. This is of particular concern to those involved in commercial purchase-and-sale transactions, where parties are often required

Act jeopardizes the ability to make survival periods conform to the commercial realities of a particular representation and warranty.

To avoid the new Act and the uncertainties of schemes designed to avoid s. 22, some lawyers have gone so far as to recommend that the laws of foreign jurisdictions govern transactions. But even this scheme is risky if the parties have no connection to the foreign jurisdiction.

## *Limitation periods have often been described as ticking time bombs.*

impact of s. 22, but the consensus is that such schemes are risky.

Until a court determines whether any of the "commercial reality" schemes are legitimate

to provide representations and warranties.

Typically, representations and warranties are subject to varying survival periods. However, the new

### **A Ticking Time Bomb?**

Limitation periods have often been described as ticking time bombs. The new Act is no exception for those who are unaware of its changes or who expect commercial reality to govern. ◆

## Gardiner Roberts News

### Municipal Law Expertise Expands

Ron Kanter has joined the firm in our Real Estate and Immigration Practice Groups. Ron specializes in municipal, planning and environmental law.

He is an advocate for landowners, developers, home-builders, businesses municipalities and residents at City Hall, the Ontario Municipal Board and the courts. Ron serves on the arbitration roster for Taron, formerly the Ontario New Home Warranty Plan. He also advises businesses and individuals on immigration matters. Ron has also been a member of Toronto City Council, the Ontario Legislature, and the Immigration and Refugee Board, and has taught Law & Planning at the University of Toronto Law School. He has also chaired the Municipal Committee of the Toronto Board of Trade.



Ron Kanter

### Gardiner Roberts Maintains Presence in OBA Activities

Bryan Skolnik was recently re-elected to the Executive Board of the Civil Litigation Section of the Ontario Bar Association. Bryan's continuation as a Member-At-Large ensures that Gardiner Roberts will continue to be well represented in this important Section of the Bar.

This Section deals with the jurisdictions of the courts in civil matters, procedural conduct of civil cases and the enforcement of judicial decisions of a civil nature.

### \$28.45 Million Commercial Real Estate Deal

Acting for the purchaser, Gardiner Roberts LLP Partner and Real Estate Practice specialist Victoria Stuart recently acted as lead counsel, with Associate Peter Moffatt, in the \$28.45 million purchase by Abacus Real Estate Investments Ltd. of the Terrarium Shopping Centre and Place Canada Trust Office Building in Pointe Claire, Quebec. ◆

## We Welcome Your Comments

Editorial Board: CeCe Cunningham, T: 416.865.6734, [ccunningham@gardiner-roberts.com](mailto:ccunningham@gardiner-roberts.com)  
 Lou Milrad, T: 416.865.6650, [lmilrad@gardiner-roberts.com](mailto:lmilrad@gardiner-roberts.com)  
 Peter Moffatt, T: 416.865.6604, [pmoffatt@gardiner-roberts.com](mailto:pmoffatt@gardiner-roberts.com)  
 Arlene O'Neill, T: 416.865.6640, [aoneill@gardiner-roberts.com](mailto:aoneill@gardiner-roberts.com)

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GARDINER ROBERTS LLP  
 Lawyers

Suite 3100, 40 King Street West

Toronto, Ontario M5H 3Y2

T: 416.865.6600

F: 416.865.6636

[www.gardiner-roberts.com](http://www.gardiner-roberts.com)

