



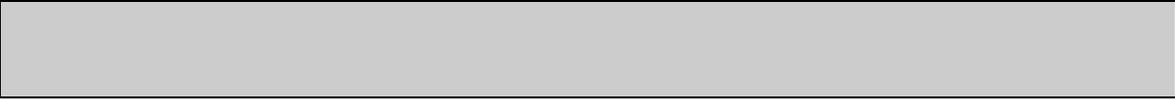
## **VENTURE CAPITAL PROGRAMS**

### **SMALL BUSINESS VENTURE CAPITAL ACT**



## **GENERAL INFORMATION**

### **OVERVIEW OF SECURITIES ACT & RELATED SMALL BUSINESS VENTURE CAPITAL LEGISLATION**



## SECURITIES ACT OVERVIEW

### *APPLICABLE TO VENTURE CAPITAL CORPORATIONS AND ELIGIBLE BUSINESS CORPORATIONS*

The following is an overview of the provisions of the British Columbia Securities Act applicable to a Venture Capital Corporation (VCC) or Eligible Business Corporation (EBC) that sells shares in British Columbia.

**THIS OVERVIEW PROVIDES GENERAL INFORMATION ONLY AND MANY DETAILS HAVE BEEN OMITTED. INTERESTED PERSONS ARE STRONGLY ADVISED TO CONSULT WITH THEIR PROFESSIONAL ADVISORS IN ORDER TO DETERMINE HOW THE SECURITIES ACT APPLIES TO THEIR PARTICULAR SITUATION. ISSUING SECURITIES WITHOUT COMPLYING WITH THE SECURITIES ACT CAN HAVE SERIOUS CONSEQUENCES.**

#### **I. Statutory Requirements**

The Securities Act contains complex rules that apply every time a share is issued out of treasury or ownership of a previously issued share is transferred. The Securities Act requires any VCC / EBC that issues shares out of treasury to:

- sell the shares under a prospectus using persons who are registered under the Securities Act to sell the shares on behalf of the VCC / EBC; or
- rely on one of the exemptions from the registration and prospectus requirements contained in the Securities Act to sell the VCC / EBC shares on an exempt basis.

#### **II. Sale of Shares under a Prospectus**

A prospectus is a disclosure document that describes a company and the shares being offered for sale by the company. A prospectus must contain full, true and plain disclosure of all material facts. The directors of a VCC / EBC will be liable to all persons who purchase shares under the prospectus if the prospectus contains a misrepresentation and the directors did not undertake the level of due diligence required by the Securities Act.

A prospectus must contain current audited financial statements of the VCC / EBC and, where the VCC / EBC intends to invest its capital in a specific small business, the prospectus may also require the financial statements of the small business along with pro forma financial statements. (See BC Policy 41-601 of the British Columbia Securities Commission)

The Securities Act requires a company using a prospectus to sell shares to file the prospectus with the British Columbia Securities Commission and to receive a receipt for it before issuing any shares under the prospectus. The Securities Commission will generally not issue a receipt for a prospectus of a VCC / EBC unless:

- the prospectus contains disclosure respecting the types of investments that will be made using the proceeds of the offering;
- the VCC / EBC has made application to have its shares listed on a stock exchange; and
- a registered dealer has been retained to act as the agent of the VCC / EBC in connection with the offering.

Once a receipt for the prospectus has been issued, the company may sell shares under the prospectus for up to 1 year from the date of the receipt for the preliminary prospectus, unless the Securities Commission limits the offering period to a shorter time period. Shares issued under a prospectus are free trading and may be resold by purchasers without restriction (subject to certain restrictions on the sale of shares by "control" persons and subject to such sales being effected through appropriately registered persons).

A company becomes a "reporting issuer" under the Securities Act on the date that a receipt for its prospectus is issued. A reporting issuer must comply with all of the continuous disclosure reporting requirements contained in the Securities Act, such as annual and quarterly financial disclosure and reporting of material changes in its affairs. Otherwise, it may be subject to a cease trade order issued by the Securities Commission.

### **III. Registration and Prospectus Exemptions**

The following exemptions contained in the Securities Act are commonly relied upon by VCC / EBCs to issue securities without having to comply with the dealer registration and prospectus requirements contained in the Securities Act. The VCC / EBC may rely on one or more of the exemptions to issue shares provided that the circumstances of its share offering fall within the scope of the exemption or exemptions. Note that the following exemptions do not allow the VCC / EBC to give advice to any purchaser of its shares as to the suitability of the purchase to that particular purchaser. Only persons registered as advisors under the Securities Act are eligible to give such advice.

## 1. Private Issuer Exemption

A VCC / EBC may sell its shares to certain prescribed purchasers if the company is a “Private Issuer” under the Securities Act. A Private Issuer is one that:

- is not a reporting issuer, a mutual fund or non-redeemable investment fund;
- whose designated securities:
  - (i) are subject to restrictions on transfer are contained in the VCC / EBC’s constating documents or agreement between securityholders;
  - (ii) are beneficially owned, directly or indirectly, by not more than 50 persons or companies, counting any two or more joint registered owners as one beneficial owner and not counting employees and former employees of the VCC / EBC or its affiliates; and
  - (iii) has distributed its designated securities only to persons or companies described in the following paragraph.

For the purpose of the foregoing “designated securities” are:

- voting securities;
- securities that are not debt securities and that carry a residual right to participate in the earnings of the VCC / EBC or, on liquidation or winding up of the VCC / EBC, in its assets; or
- securities convertible, directly or indirectly, into the foregoing.

Notwithstanding that a VCC / EBC may be a private issuer, purchases of its securities are limited to a prescribed group as follows:

- a director, officer, employee or control person of the VCC / EBC;
- a spouse, parent, grandparent, brother, sister or child of a director, senior officer or control person of the VCC / EBC;
- a close personal friend of a director, senior officer or control person of the VCC / EBC;
- a close business associate of a director, senior officer or control person of the VCC / EBC;
- a current holder of designated securities of the VCC / EBC;
- an accredited investor;
- a person or a company that is wholly owned by any combination of persons described in the foregoing; or
- a person or a company that is not the public.

The term “public” is not defined in the Securities Act. Whether or not a person is a member of the Public in relation to the VCC / EBC will depend on the particular facts of each case. A person will not be a member of the “public” in relation to a VCC / EBC if he is in a close relationship with a principal of the VCC / EBC thereby giving him access to information about the VCC / EBC and an opportunity to assess the integrity, character and business ability of the principals of the VCC / EBC. The Courts have interpreted the “public” very broadly in the context of securities trading and therefore legal counsel should be consulted for further guidance to ensure that the sale of shares by a VCC / EBC is not being made to a member of the public.

In addition, the purchaser of the securities from a private issuer must be purchasing as “principal” and not on behalf of any other party unless deemed to be purchasing as principal under relevant securities legislation (i.e. as a portfolio manager purchasing for accounts that are fully managed by it).

No disclosure document is required to be delivered to the purchasers of shares issued by a VCC / EBC under the private issuer exemption and there is no time limit on the use of the exemption. Once however a VCC / EBC sells its designated securities to any parties other than those listed above, it may no longer rely upon the private issuer exemption to distribute designated securities. The VCC / EBC will however be able to rely upon other exemptions available under the Securities Act to sell its shares.

A VCC / EBC that is no longer a private issuer does not become a “public company” (more properly known as a “reporting issuer”) unless and until it files a prospectus and obtains a receipt for that prospectus from the relevant securities authorities.

## **2. Family, Friends, and Business Associate Exemption**

A VCC / EBC may also sell its shares to the following parties provided they purchase the shares as principal:

- a director, senior officer or control person of the VCC / EBC or of an affiliate of the VCC / EBC;
- a spouse, parent, grandparent, brother, sister or child of a director, senior officer or control person of the VCC / EBC or an affiliate of the VCC / EBC;
- a close personal friend of a director, senior officer or control person of the VCC / EBC, or an affiliate of the VCC / EBC;
- a close business associate of a director, senior officer or control person of the VCC / EBC, or of an affiliate of the VCC / EBC, or
- a person or company that is wholly owned by any combination of persons or companies described in the foregoing paragraphs.

In order to rely upon the foregoing exemption, a VCC / EBC does not have to a private issuer and there is no disclosure document required to be delivered to a purchaser of shares issued under the exemption. There is however a report and prescribed fees which must be filed with the British Columbia Securities Commission disclosing the sale of shares within 10 days of the issuance of any shares.

### **3. Offering Memorandum Exemption**

A VCC / EBC may sell its shares to a person or company purchasing the shares as principal, provided that at the same time or before the purchaser of the shares signs the agreement to purchase the shares, the VCC / EBC delivers an offering memorandum to the purchaser and obtains a signed Risk Acknowledgement Form from the purchaser in compliance with Multilateral Instrument 45-103 titled "Capital Raising Exemptions".

The form of offering memorandum required to be delivered to a purchaser is prescribed by Multilateral Instrument 45-103 as Form 45-103F1 titled "Offering Memorandum for Non-Qualifying Issuers".

In order to rely upon the offering memorandum exemption, the VCC / EBC must hold in trust all consideration received from the purchaser of its shares until midnight on the second business day after the purchaser signs the agreement to purchase the shares. The VCC / EBC must return all consideration to the purchaser of shares promptly if the purchaser exercises its right to cancel the agreement to purchase the shares. This right allows the purchaser to cancel the agreement to purchase the shares by delivering notice to the VCC / EBC not later than midnight on the second business day after the purchaser signs the agreement to purchase the shares. Use of the exemption also requires the VCC / EBC to retain the signed Risk Acknowledgment Form for at least six years after the issuance of the shares to each purchaser. The prescribed form of offering memorandum also provides purchasers with statutory rights for rescission or damages in the event that the offering memorandum contains a misrepresentation.

Within 10 days after the issue of any shares a report disclosing the sale, along with a copy of the offering memorandum and prescribed fees, must be filed with the British Columbia Securities Commission.

### **4. Accredited Investor Exemption**

A VCC / EBC may also sell its shares to a person or company purchasing the shares as principal if the purchaser is an accredited investor as described above and more particularly defined in Multilateral Instrument 45-103 titled "Capital Raising Exemptions".

For the purposes of the foregoing, the definition of an “accredited investor” is very lengthy and Multilateral Instrument 45-103 titled “Capital Raising Exemptions” should be consulted for a precise definition. Generally however the definition includes certain financial institutions, government entities and the following:

- an individual who, either alone or jointly with a spouse, beneficially owns, directly or indirectly, financial assets having an aggregate realizable value that before taxes, but net of any related liabilities, exceeds \$1,000,000;
- an individual whose net income before taxes exceeded \$200,000 in each of the two most recent years or whose net income before taxes combined with that of a spouse exceeded \$300,000 in each of the two most recent years and who, in either case, reasonably expects to exceed that net income level in the current year; or
- a corporation, limited partnership, limited liability partnership, trust or estate, other than a mutual fund or non-redeemable investment fund, that had net assets of at least \$5,000,000 as shown in its most recently prepared financial statements.

In this instance, a VCC / EBC is not required to deliver an offering memorandum or other form of disclosure document to the accredited investor, however the VCC / EBC must file a report disclosing the sale of shares (along with prescribed fees) within 10 days following the issuance of any shares.

#### **5. \$97,000 Exemption**

A VCC / EBC may sell shares to any person provided the person agrees to purchase shares having an aggregate acquisition cost of not less than \$97,000 and is purchasing the shares solely for his own account.

An Offering Memorandum is not required to be delivered to the purchaser unless the VCC / EBC advertises in connection with the sale of the shares. There is no limit on the number of purchasers that can be issued securities under this exemption during any particular time period.

This exemption is scheduled to be cancelled in April of 2003. Therefore, legal counsel should be contacted before relying on this exemption to ensure that it is still available and if so, whether it has been amended in any way. Using the exemption requires the VCC / EBC to file a report (along with prescribed fees) with the British Columbia Securities Commission within 10 days following the issuance of any shares.

## 6. Additional Exemptions

There are other limited exemptions contained in the Securities Act that may be available for use by a VCC / EBC depending on the circumstances of a proposed offering of shares. A securities lawyer should be consulted for advice concerning the possible application of other exemptions.

## 7. Consequences of Non-Compliance

If a VCC / EBC issues shares in circumstances in which an exemption was not available to be relied upon and a prospectus was not filed or if the exemption relied upon was not properly implemented, the offering will contravene the Securities Act and the VCC / EBC along with its directors and officers may be subject to administrative sanctions under the Securities Act. In addition, the purchasers of the shares may have certain rights of rescission of the share purchase or damages against the VCC / EBC and its directors and officers.

## 8. Resale Rules

Shares issued under any of the exemptions described above are subject to rules contained in the Securities Act that restrict the ability of a purchaser of shares to sell the shares until certain requirements are satisfied. These requirements include a requirement that the company issuing the shares must have been a reporting issuer for at least 12 months prior to the date that the shareholder of the company sells his shares. If a shareholder of a company that has not been a reporting issuer for 12 months wishes to sell shares subject to these resale restrictions, he must either file a prospectus or find an exemption in the Securities Act to rely on in order to be able to lawfully sell his shares. As most VCC / EBCs however do not become reporting issuers, the 12-month reporting issuer requirement will never be satisfied so the resale rules cannot be fulfilled.

If the resale rules cannot be fulfilled, a purchaser may have three other resale options:

- if the VCC / EBC agrees, sell his shares back to the VCC / EBC (note such a resale would trigger the repayment of tax credits by the VCC / EBC if it occurs before 5 years);
- sell the shares under a prospectus (which is most often impractical); or
- rely on an exemption from the prospectus and registration requirements which applies to resales and not just to treasury issues (i.e. the “Private Issuer”, “Family, Friends and Business Associates”, “Accredited Investor” or “\$97,000” exemptions discussed above. Note however that the “Offering Memorandum” exemption would not be available in such resale circumstances).

Otherwise, a shareholder of a non-reporting VCC / EBC will effectively be unable to transfer his shares to any other person, including his spouse, for valuable consideration.

#### **IV. Related Small Business Venture Capital Act Requirements**

Any offering document (i.e. offering memorandum or prospectus) prepared or used by a VCC / EBC must be submitted to program staff for review prior to distribution. The document must include disclosure statements as outlined in the Offering Memorandum Insert. This insert provides a short description of the *Small Business Venture Capital Act* and its requirements. Please contact program staff for a copy of the insert.

Certain disclosure statements must be set out in the offering document verbatim. These include the following:

**In registering the VCC / EBC under the *Small Business Venture Capital Act*, the Province of British Columbia makes no representations with respect to any tax considerations discussed in this document other than with respect to those dealing with the tax credit available in respect of the purchase on shares of the VCC / EBC.**

**The Province of British Columbia in no way guarantees the value of any shares issued by a venture capital corporation or eligible business corporation registered under the *Small Business Venture Capital Act*. Nor does it in any way express an opinion as to the financial condition of the issuing company, the merits of an investment in shares of the issuing company, or the merits of its investment in eligible small businesses.**

**The review of this offering document by Equity Capital Program staff was limited specifically to the requirements of the *Small Business Venture Capital Act* only and any other matters which concern investors should be reviewed with their own personal advisors.**

## **SMALL BUSINESS VENTURE CAPITAL LEGISLATION**

**Re: *Small Business Venture Capital Act &  
Small Business Venture Capital Regulation***

The *Small Business Venture Capital Act* and the Small Business Venture Capital Regulation is the empowering legislation authorizing the registration of venture capital corporations and the issuance of tax credit certificates to eligible investors in registered venture capital corporations or eligible business corporations.

The Act and Regulation may be viewed and downloaded at the Investment Capital Branch's web site: [www.bcinbusiness.gov.bc.ca/](http://www.bcinbusiness.gov.bc.ca/).

The legislation may also be ordered from Crown Publications. To order, contact:

**Crown Publications Inc.  
421 Fort Street  
Victoria, British Columbia  
V8W 1E7  
Telephone: (250) 386-4636  
Fax: (250) 386-0221  
Web site: [www.crownpub.bc.ca](http://www.crownpub.bc.ca)**

**NOTE:** Both the Act and the Regulations are periodically amended so you should ensure you have the latest version of each.