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Blaney McMurtry
BARRISTERS & SOLICITORS LLP

Blaneys on Business

This newsletter is designed to bring news of changes to the law, new law, interesting deals and other matters of interest to our commercial clients and friends. We hope you will find it interesting, and welcome your comments.

Feel free to contact any of the lawyers who wrote or are quoted in these articles for more information, or call the head of our Corporate/Commercial Group, John C. Papadakis at 416.597.3998 or jpapadakis@blaney.com.

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"...almost half of Canadian executives are expecting to pursue an acquisition this year and about one third are expecting to divest, signaling an increase in volume ahead."

LOOKING FOR A GROWTH OR EXIT STRATEGY? BE ALERT TO CHANGING WINDS IN PRIVATE EQUITY

Dennis J. Tobin and Patrick Gervais

Increasing numbers of Canadian business owners appear to be looking for opportunities to grow their business or exit them by way of a merger or sale. Business owners who have sailed their companies clear of the financial storms that started in 2008 remark on an eerie calm in the M&A business where there is a lot of money on the sidelines and stories of big deals but no obvious transactions for them on the horizon.

The *Financial Post Crosbie: Mergers & Acquisitions in Canada* report for the first quarter of this year illustrates a surge in the value of M&A deals. The Ernst & Young May 2012 *Global Capital Confidence Barometer* survey also states that almost half of Canadian executives are expecting to pursue an acquisition this year and about one third are expecting to divest, signaling an increase in volume ahead. This volume may be affected further by private company succession planning. There will be more businesses available for sale as boomers with private companies look to retire over the next several years.

Venture capitalists and private equity firms are destined to have a major role in all of this anticipated M&A activity. The recent Canadian Venture Capital and Private Equity Association (CVCA) national conference in Montreal, attended by 1,800 specialists in the field, examined some of the key factors, trends and issues that are affecting both buyers and sellers. There are a number of trends converging in the market which were discussed, suggesting some movement and direction.

While M&A activity has improved since 2008, valuations have not yet returned to 2007 levels. Sellers often overvalue their companies by continuing to use pre-recession valuations while buyers are less anxious to spend their money, creating a gridlock when trying to negotiate a deal. Financial investors thus have a harder time finding suitable companies because of the problem of closing the price gap with sellers.

Many companies have a lot of cash waiting for the right investment opportunity. There are untold millions waiting to find an investment that pays more than bank accounts and the stock markets. Strategic investments by cash rich companies are one of the better opportunities for sellers if they are well placed. Strategic buyers have more latitude to give sellers what they want, including a valuation premium if the investment secures a new market, produces synergies or results in cost savings.

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"In the realm of private company succession planning, over half of Canadian family business owners are not expecting an intra-family next generation transfer and a third are hoping to attract a private equity investor (PwC Capital Markets Flash, January 2012)."

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Private equity firms will continue to invest in their own portfolios until the combination of opportunities and prices align once again. It is very much the same as what investors are doing in the commercial real estate markets. Real estate transactions have been one of the driving forces of the economy since the 2008 recession. As properties get more expensive, however, real estate investment trusts and private investors are investing in their own properties rather than chasing new fully priced deals.

New opportunities may be found in making bids for public companies and/or taking public companies private. Investors are turning to depressed financial markets to find undervalued public companies and taking companies private to reduce compliance costs.

In the realm of private company succession planning, over half of Canadian family business owners are not expecting an intra-family next generation transfer and a third are hoping to attract a private equity investor (PwC Capital Markets Flash, January 2012). This transition is already happening. Over a quarter of family businesses plan to embark on a transition within the next five years. Sellers need to understand where they are in the market, what the prices are like and what options they have. The current trends will impact those options.

Even though there are signs of growth in mergers and acquisitions over the past couple of years, the transactions are different and they do not necessarily translate into higher prices. There are some less obvious factors in the market putting downward pressure on prices such as the need by private equity firms to turn over portfolio companies and some more mundane reasons such as company earnings that have not yet recovered to 2007 levels.

In order to best position themselves for a potential sale, sellers should evaluate their options: transitioning through family succession or a management team, bringing in a strategic investor or approaching a strategic buyer. One of the propositions put forward by the organizers of the CVCA conference was that "active management by highly skilled private investors is the secret sauce. These investors jump right into their portfolio companies, working alongside management to truly transform these businesses".

Companies looking to transition within the next five years should start by cleaning up their books well in advance of a planned transaction. Failure to do so could at best defer closing and at worst uncover surprises that would push investors to walk away from the deal. Private businesses should also make sure they qualify for the capital gains exemption to maximize return on the sale of the business. Certain assets in the balance sheet could disqualify business owners from claiming the capital gains exemption. Complex corporate structures can also deter potential investors and buyers. Simplifying the ownership structure can take time and should be dealt with well in advance of seeking a transaction.

Sellers looking for an exit should also spend less time *in* the business and more time *on* the business by focusing on maximizing value, prioritizing goals and increasing profit margins. Sellers should market their business as a target by determining who needs their business from a competitive, market and strategic partner standpoint.

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"A properly drafted overtime policy can help an employer dealing with managing overtime, but it will not provide perfect protection from liability for overtime if worked. Rather, employers must be diligent in ensuring that employees do not exceed the overtime thresholds."

Patrick Gervais is a member of Blaney McMurtry's corporate commercial practice group. A member of the Ontario and New York Bars, his practice involves a wide range of commercial matters. He has acted for clients in a variety of industries including natural resources, technology and finance. Patrick has a particular interest in international trade and emerging markets. He is fluent in French and has working knowledge of Spanish and Chinese.

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Strategic buyers are willing to pay premiums and premiums can be justified when sellers are offering exposure to new markets, increased market share, economies of scale and the addition of capabilities that leverage much larger existing opportunities for the buyer.

Sellers should also look at new markets for potential buyers. For every dollar on the sidelines in Canada, there are many more in the USA. Foreign interest is also increasing for cash rich investors looking for safe or strategic investments in Canada, especially in the natural resources and real estate sectors.

Perhaps while the venture capital and private equity markets are in the doldrums, owners who want to grow or exit their businesses should check their charts, clean their decks and fix their sails, as both fair winds and gales are in their future. In the meantime,

Day after day, day after day,
We stuck, nor breath nor motion;
As idle as a painted ship
Upon a painted ocean.
-Coleridge-Rime of the Ancient Mariner ■

MISTAKEN BELIEF ABOUT OVERTIME PAY COULD BE EXPENSIVE FOR ONTARIO EMPLOYERS

David E. Greenwood

There is a popular belief that salaried employees in Ontario are not entitled to overtime pay. This mistaken belief can prove costly for employers.

Pursuant to the *Employment Standards Act, 2000*, all employees, except those who fall within specified exemptions, are entitled to overtime. The Act makes no distinction between salaried employees or hourly employees.

In recent years, there has been a proliferation of claims made against employers for unpaid overtime. The most notable examples are the class action lawsuits that have been commenced against large employers, including the banks. But this is not an issue facing only large employers. Many small companies rely upon employees who work more than the applicable threshold for overtime. The failure to pay these employees at the overtime rate, or to allow them to bank their overtime at the overtime rate, may cause an unexpected liability. If the employer has a number of employees who work overtime, overtime liabilities can affect profit and expense projections significantly if not in the employer's budget.

Moreover, it does not matter that the employer has not approved the overtime worked. The focus is whether or not the overtime was actually worked. A properly drafted overtime policy can help an employer dealing with managing overtime, but it will not provide perfect protection from liability for overtime if worked. Rather, employers must be diligent in ensuring that employees do not exceed the overtime thresholds. If employees do work overtime, the employer must be sure to maintain accurate records of the overtime worked and make provisions for it to be paid to the employee or credited to the employee's overtime "bank". This will help employers avoid unexpected overtime claims and liabilities in the future.

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"The sale and purchase of prospectus-exempt securities in Canada has become increasingly important for investors and issuers, particularly for those who participate in the exempt capital market in Ontario."

David E. Greenwood is a member of Blaney McMurtry's Labour & Employment and Commercial Litigation practice groups. He has acted for employers and employees across a wide variety of industries, representing clients in files involving wrongful dismissals, constructive dismissals, human rights complaints, pension issues, disability claims, allegations of employee fraud, theft of confidential and proprietary information, breach of fiduciary duties and misappropriation of corporate opportunities. He is routinely retained to draft or to negotiate employee policy manuals, employment agreements, and other employment-related documents.

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Here are some other popular overtime myths:

Myth: If employees do not use banked overtime hours those hours will be lost.

Truth: An employer cannot cause an employee to forfeit banked overtime.

Myth: Supervisory or management level employees are not entitled to overtime.

Truth: Supervisory or management level employees may be entitled to overtime for work that is not directly related to supervisory or managerial duties and if that work is not performed on an irregular or exceptional basis.

Myth: Overtime is paid after 44 hours of work.

Truth: There are different overtime thresholds for different industries or job categories. Most of the exceptions and thresholds are set out in O Reg 285/01 *Exemptions, Special Rules and Establishment of Minimum Wage*.

Our clients will be pleased to note that there are no limits on the overtime that can be worked by lawyers!

If you have not reviewed your firm's overtime policy and tracking and budgeting systems to satisfy yourself that they are current and effective, this might be a good time to do it. ■

ONTARIO SECURITIES COMMISSION REVIEWING FINANCING AND INVESTING RESTRICTIONS ON BUSINESSES, INVESTORS

Brian L. Prill

The Ontario Securities Commission (OSC) is conducting a public consultation that could end up providing businesses with broader access to fresh capital and investors with greater opportunities to buy securities issued by those businesses.

The OSC consultation concerns the so-called exempt capital market. Pursuant to Canadian securities laws, any company issuing stocks, bonds and other securities in Canada is obliged to prepare and publish a prospectus that details what is being offered, so that investors will be able to make thoroughly informed purchasing decisions.

There are, however, exemptions from the time-consuming and expensive prospectus requirement -- the "private issuer" exemption, that tends to be used by private companies, is one example, and the "accredited investor" exemption, that tends to be used by public companies, is another.

The OSC is soliciting comment on whether current prospectus exemptions available in Ontario should be narrowed or broadened.

Brian Prill, a Blaney McMurtry specialist in corporate finance and securities law, and a leading authority on raising capital through private placements (financings in which prospectuses are not required), reports here on the OSC consultation and encourages both corporations and investors to make their views known to the commission.

The sale and purchase of prospectus-exempt securities in Canada has become increasingly

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"The total amount of capital raised through all prospectus-exempt distributions reported to the Ontario Securities Commission (OSC) in 2011 was approximately $142.9 billion."

Brian Prill is a partner in Blaney McMurtry's Corporate/Commercial, Corporate Finance/Securities, and Mining practice groups. A member of the Ontario and New York State bars, his practice includes a strong focus on the laws governing corporations seeking to raise money from the capital markets under an exemption from publishing a prospectus, which is a costly process. Past-president of the Exempt Market Dealers Association of Canada, Brian advises investment dealers, exempt market dealers, small to mid-size exploration and mining corporations, and new venture start-ups on a host of securities and corporate law issues

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important for investors and issuers, particularly for those who participate in the exempt capital market in Ontario.

The total amount of capital raised through all prospectus-exempt distributions reported to the Ontario Securities Commission (OSC) in 2011 was approximately $142.9 billion. Approximately $86.5 billion of that was raised directly in Ontario, of which approximately $72.8 billion was raised using the "accredited investor" prospectus exemption.

This prospectus exemption, plus the underlying principles regarding prospectus exemptions available to residents of Ontario, is now under review. The results of this review will depend on the comments that the OSC receives from issuers, investors, registered dealers and other interested stakeholders that participate in the exempt capital market in Ontario.

Background

On November 10, 2011, the staff of the Canadian Securities Administrators (CSA), the voluntary umbrella organization of all provincial and territorial securities regulators, published CSA Staff Consultation Note 45-401 - *Review of Minimum Amount and Accredited Investor Exemptions*. This note provided background information on the two prospectus exemptions under review, set out a series of consultation questions, and asked interested stakeholders to submit their comments to their respective provincial/territorial securities commissions by February 29, 2012.

After CSA's comment period closed last June 7, the OSC published OSC Staff Notice 45-707 - *OSC Broadening Scope of Review of Prospectus Exemptions*. In this notice, the OSC announced that it is expanding its review of the prospectus exemptions available in Ontario.

Specifically, it is going to publish a second consultation note and, over the next year, will give all market participants (issuers, investors, dealers and other interested stakeholders) a chance to comment on the accredited investor prospectus exemption and the minimum purchase prospectus exemption. The OSC would also like to receive comments regarding some of the broader issues that were raised during the CSA consultation period, including harmonizing some of the Ontario prospectus exemptions with the prospectus exemptions available in the rest of Canada.

OSC Mandate

The OSC stated that in considering changes to the prospectus exemptions available in Ontario, it would be guided by two principles -- protecting investors from unfair, improper, or fraudulent practices, and fostering fair and efficient capital markets and confidence in those markets.

As part of its consultation process, the OSC will consider under what circumstances investors do not require the protections afforded by a prospectus.

Comments from Ontario Issuers and Investors

One of the questions raised in the CSA consultation note was whether the income threshold criteria for qualifying as an "accredited investor," (as set out in National Instrument 45-106 - *Prospectus and Registration Exemptions*) is too low. The CSA noted that the current individual annual income threshold of $200,000 was initially based on the individual annual income figures established by

"The income threshold test was perceived by many to be undemocratic in that it restricted participation in the exempt capital market to a select group of investors that represented less than 1 per cent of the total population of Canada (247,450 Canadians in 2009)."

the United States Securities and Exchange Commission (SEC) in 1982. This threshold was subsequently adopted in many Canadian provinces and territories in the early 2000s and in Ontario in 2001. Adjusted for inflation, this individual annual income threshold would equate to over $443,000 (based on 1982 dollars) or $245,000 (based on 2001 dollars).

One of the principles underlying the annual income and capital accumulation threshold tests in the accredited investor exemption is that wealth is a measurement of sophistication. The assumptions underpinning the income threshold test are that:

(i) if an individual is able to generate a yearly income of $200,000, then the individual must be sophisticated enough to determine whether the purchase of a security sold without the disclosure contained in a prospectus is the correct fit for the investor's investment objectives and risk tolerance, and

(ii) if the investor were to lose the entire investment amount, the investor has sufficient wealth-generating capacity or has accumulated sufficient wealth to withstand the loss of that investment.

The consultation note contained numerous questions with respect to whether the income threshold tests for accredited investors should be raised. However, a common theme that the OSC heard from market participants during its participation in the CSA consultation process was that wealth was a poor measurement of sophistication. The income threshold test was perceived by many to be undemocratic in that it restricted participation in the exempt capital market to a select group of investors that represented less than 1 per cent of the total population of Canada (247,450 Canadians in 2009). Raising the individual income threshold figure to $250,000 to account for inflation since 2001 would further reduce that number to 156,520 Canadians (0.63 per cent of the population), which would restrict the size of the exempt capital market for issuers and also deny a number of individuals access to investment products in which they had previously invested.[1]

There is also the issue of whether the income threshold test has the effect of also discriminating against Canadians by geographic region. For example, in Newfoundland, only 0.49 per cent of the population has an annual income over $200,000 whereas, in Ontario and Alberta, individuals with annual incomes over $200,000 comprise 1.14 per cent and 1.94 per cent of the population respectively.

The net effect of an arbitrary annual income-level test under the accredited investor prospectus exemption is to create a regime that provides certain individuals with investment opportunities based on their income-generating capacity, magnified by regional economic differences, rather than a regime founded on an equality of investment opportunity as measured by the actual sophistication of the investor.

Another issue with respect to using the annual income threshold as a measurement of sophistication is the idea that the individual investor is the

[1] Source - Total Canadian Income figures published online by Statistics Canada.

"Although securities are sold in Ontario using an offering memorandum, Ontarians are usually only able to buy these securities if they qualify as accredited investors."

person who has to possess the appropriate level of sophistication before he or she can actually purchase an exempt market security. The annual income threshold test ignores both the investor's level of education and the investor's ability to obtain investment advice from registered investment dealers.

The proposal that was presented by a number of commentators on the CSA Consultation Note was that, given the rise in education levels in Canada, many investors possess the requisite sophistication to determine their own investment objectives and risk tolerance or engage a qualified investment adviser to help them make an investment decision.[2]

Many commentators also perceived the lack of equality of opportunity as going beyond the regulator's mandate of investor protection because it denies a significant number of individuals the right to determine their own investment objectives.

Another major theme was the lack of harmonization of prospectus exemptions available in Canada. For example, Ontario is the only province that does not allow investors to buy an exempt-market security using the "offering memorandum" prospectus exemption. (An offering memorandum is an offering document that discloses the issuer's business model and the investment risk.) Although securities are sold in Ontario using an offering memorandum, Ontarians are usually only able to buy these securities if they qualify as accredited investors. In Alberta, on the other hand, any investor can purchase a security that is offered pursuant to the offering memorandum prospectus exemption so long as the size of the purchase is limited to $10,000.[3]

Another example of a prospectus exemption that lacks harmonization across Canada is the "Family, Friends, and Business Associates" exemption. Because Ontario does not recognize this exemption, situations arise whereby "close business associates" or "close personal friends" of a director or executive officer of an issuer who live in any province of Canada, other than Ontario, can buy a security of that issuer while Ontario family, friends and business associates, typically, cannot -- unless they earn in excess of $200,000 and therefore qualify as accredited investors.

For issuers of securities in Ontario's exempt capital market, this lack of harmonization restricts the size of the capital market pool to which the issuer has access. For investors resident in Ontario, this lack of harmonization restricts the number and variety of their investment opportunities. In many cases non-accredited investors are

[2] For example, in 1990, only 40 per cent of the population had any college or university education, according to Statistics Canada. By 2005, that figure had increased to 56 per cent.

[3] Note that the CSA has also published Multilateral CSA Staff Notice 45-309 - *Guidance for Preparing and Filing an Offering Memorandum under National Instrument 45-106 - Prospectus and Registration Exemptions*. In this notice the CSA has outlined a number of common deficiencies that the various provincial securities commissions have identified with respect to the disclosure provided in offering memorandums. While the offering memorandum prospectus exemption may provide a more "democratic" regime by allowing a wider spectrum of investors to participate in the exempt securities market, critics of the offering memorandum point to the number of common deficiencies in such documents as evidence of a prospectus exemption that does not provide adequate protection for the less "sophisticated" investor. Some of the issues the OSC will be reviewing in its extended consultation period will be: (i) the level of disclosure provided in a prospectus exempt offering document, (ii) the provision of statutory rights of rescission (the right to cancel the agreement and have the money refunded) or an action in damages where there is a misrepresentation in such a document, and (iii) the involvement of a registrant or broker whenever a security is sold to an investor under a prospectus exemption.

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simply denied access to exempt market securities, regardless of whether they have the sophistication to determine the quality of the investment product or are able to obtain advice from a registered investment dealer. Many commentators stated that this creates a small "elite" group of investors who are granted access to the exempt capital market and disenfranchises other investors who want to participate in that market.

Conclusion

The comments above speak to only a few of the issues that the OSC Staff Notice has identified for further review. Ontario issuers and investors now have a window of opportunity to determine the size of the exempt capital market and their ability to participate in it. Companies that issue, or wish to issue, prospectus-exempt securities in Ontario, or investors who would like to buy, or continue to buy, prospectus-exempt securities, should review the OSC Staff Notice and contact their legal counsel to determine how they can best make their views known to the OSC. ■

Blaneys Welcomes Peter Hand

Blaney McMurtry is pleased to announce that Peter Hand has joined the firm. Peter has over 30 years of experience in the areas of commercial real property and leasing. Throughout his practice, Peter has developed significant expertise in the acquisition and disposition of real and leasehold property and commercial leasing. He acts for owners and investors in connection with the acquisition, development and disposition of commercial projects and represents both landlords and tenants in lease negotiations and operational and construction matters.

Peter was called to the Bar of Ontario in 1974.

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