

Business Law

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## Regulation 45-106 and Restrictions on the Transfer of Securities: Did We Cry Wolf Too Fast?

*Regulation 45-106 respecting prospectus and registration exemptions* (“**Regulation 45-106**”) has caused much concern and plenty of ink to flow since it came into force on September 14, 2005. The purpose of this newsletter is to discuss the modification made by Regulation 45-106 with respect to the restrictions that must be contained in an issuer’s constating documents in order for the issuer to have private issuer status<sup>1</sup>. It also provides an enlightened answer to the question that begged to be asked and that is “**Am I required to amend my company’s articles before October 12, 2007?**”

### **Background**

Regulation 45-106 introduced a new concept, that of “private issuer”, which replaces that of “private company”, which was previously found in Quebec’s *Securities Act* (the “**SA**”). The articles of a private company were required to contain the following three elements:

- a limitation on the number of shareholders to 50;
- a restriction on the transfer of **shares**; and
- a prohibition against public offerings.

Under Regulation 45-106, an issuer who wishes to qualify as a private issuer is required to ensure that its **securities, other than non-convertible debt securities**, are subject to restrictions on transfer in its constating documents or security holders' agreements<sup>2</sup>. Furthermore, it is no longer necessary for a private issuer’s constating documents to limit the number of shareholders to 50 or to prohibit public offerings.

On October 14, 2005, the Autorité des marchés financiers (“**AMF**”) issued a general exemption under which a two-year moratorium was granted to private companies to amend their articles in order to provide for restrictions on the transfer of their securities in addition to or in replacement of the restrictions contained therein respecting shares. The moratorium will end on October 12, 2007.

During the last year, it has been suggested more than once that all private companies should amend their articles before October 12, 2007. As we explain below, these were alarmist opinions that recommended amending the articles of many companies that are not legally required to do so.

An AMF document published on March 31, 2006 set out the opinions of its staff on various issues related to Regulation 45-106, including on the necessity or advisability for a private company to amend its articles. The AMF recently unequivocally confirmed its position on the issue by means of a clarifying statement available on its website.

**Which companies are covered under Regulation 45-106 and the private issuer concept?**

Any company that issues securities in Quebec or from Quebec is covered under Regulation 45-106. Whether it has only one shareholder or 40 of them, whether it is an operating or holding company, it is subject to Regulation 45-106.

**Why is it desirable to qualify as a private issuer?**

Qualifying as a private issuer allows a company to be exempt from the application of several provisions of the SA. Thus, a private issuer may, subject to compliance with the provisions of Regulation 45-106, issue securities (and thus obtain financing) without having to prepare a prospectus, without going to a broker and without even having to notify the AMF.

However, once lost, private issuer status cannot be regained and hence the importance of ensuring compliance with Regulation 45-106 in the context of every transaction.

**The position of the AMF**

As we near the end of the two-year moratorium, the AMF deemed it desirable to cool down the situation and intervene in the debate on the necessity to amend the articles of a former private company in order for it to qualify as a private issuer.

Essentially, the AMF indicates that few former private companies are required to amend their articles before October 12, 2007, which is an opinion that we share.

**Am I required to amend the articles of my company by October 12, 2007?**

**YES**, if your company has issued securities other than shares (for example, employee stock options, warrants or convertible debentures).

**NO**, if your company's only outstanding securities consist of shares, regardless of their class. In this case, the restriction pertaining to the transfer of shares contained in the articles of your company is enough for it to qualify as a private issuer since the shares then constitute the securities.

**Will I be required to amend the articles of my company later on?**

**YES**, if you want your company to issue securities (other than shares) and the restrictions required to comply with Regulation 45-106 are not provided for in a security holders' agreement. It will then be important to amend your company's articles prior to issuing the securities in order for it to have private issuer status.

**NO**, in other cases.

**Additional recommendation**

If you must amend the articles of your company for any reason whatsoever (change of name, creating a new class of shares, etc.), you should avail yourself of the opportunity to insert in its articles the new restriction pertaining to the transfer of securities in lieu of the restrictions that were peculiar to private companies. Doing so will not entail additional costs and will ensure that your company's articles will contain the provisions required under Regulation 45-106 in anticipation of any future transaction in your company's securities.

Please note that this newsletter only deals with one aspect of the private issuer concept. We invite you to consult your legal counsel when issuing or transferring shares or other securities of your company to ensure that all applicable provisions of Regulation 45-106 and the SA are complied with.

Please do not hesitate to communicate with us should you have any question pertaining to the subject of this newsletter.

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1. For a more detailed study of Regulation 45-106 as a whole, please see newsletter entitled *New Private Placement Rules: Quebec Harmonizes its Rules with the Rest of Canada*, published by our colleagues René Branchaud and Sébastien Vézina in September 2005.

2. Section 2.4 (1)(b)(i) of Regulation 45-106. In this newsletter, when we refer to “securities”, we mean securities other than non-convertible debt securities.

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