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# SECURITIES ALERT

## Issues to Consider for Corporations Contemplating Crowdfunding

### Some questions to ask yourself

The Ontario Securities Commission (the “OSC”), has taken the first step towards considering a potential crowdfunding exemption as part of its wider review of the exempt market in Ontario. As part of this review, the OSC has set out a crowdfunding exemption concept (the “model exemption”). This concept will undoubtedly undergo further change and the OSC may in the end decide not to introduce a crowdfunding exemption at all. Nevertheless, the idea of crowdfunding has been greeted with enthusiasm by both potential issuers and potential investors. In short, they say crowdfunding will give small business better, faster access to funding from numerous small investors. What’s not to like? Crowdfunding certainly has its benefits. However, there are a few issues a potential crowdfunding issuer should consider prior to using a crowdfunding exemption.

**Will there be too many shareholders?** The essence of crowdfunding is that many small subscribers quickly add up to a significant fund raising amount. The corollary is that an issuer obtaining funds under the model exemption quickly acquires a large number of shareholders. This has several implications. For instance, a potential buyer may not be able to rely on the take-over bid exemptions contained in Canadian securities law for non-reporting issuers. Thus, crowdfunding issuers with a large number of security holders may become less appealing acquisition targets.

More prosaically, a large number of shareholders will likely increase the day to day administrative burden for crowdfunding issuers, which will then have to deal with administrative requests from shareholders for securities transfers, notices, inquiries and other investor relation matters. An issuer obtaining funds under the model exemption will also likely lose its ability to pass written shareholders’ resolutions because it will become logistically difficult or perhaps even impossible, to obtain the signatures of all of its shareholders.

**Will the exit strategy become more complicated?** A potential buyer may not be able to rely on the private issuer take-over bid exemption for any acquisition transaction because the exemption is restricted to issuers with less than 50 beneficial holders in Ontario. In certain transactions, an issuer obtaining funds under the model exemption may be subject to the mandatory proxy solicitation requirements of its governing statute, which, if applicable, will require it to prepare and deliver a management proxy circular for the shareholders’ meeting called to approve such transaction. In general, using the model exemption could make an exit strategy transaction more expensive and time consuming.

**What are the costs of crowdfunding?** The model exemption requires issuers to use a portal, which must be registered in a similar manner as an investment dealer or adviser. The compliance and other costs of the funding portal will likely be passed on to crowdfunding issuers. As a result, crowdfunding may turn out to be an expensive way to raise small sums.



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**What are the obligations of crowdfunding?** The model exemption contemplates that investors will have a statutory right of damages or rescission in the event of misrepresentation in the information statement that will be required in order to obtain the model exemption. In addition, Canadian securities regulators will be able to review the information statement and any other disclosure provided by issuers relying on the model exemption. Crowdfunding issuers may spend significant amounts of time dealing with issues and concerns raised by Canadian securities regulators and may find it prudent to consult with securities lawyers in the production of the required information statement.

**What about future financings?** Use of the model exemption could also make subsequent financings more difficult. Future investors will be concerned about the issuer's compliance with securities law when it used the model exemption. This may make the due diligence review for future financings more lengthy and time consuming. Future investors may not be willing to incur the increased due diligence costs and some law firms may not issue opinions regarding the validity of previous crowdfunding transactions.

Crowdfunding has benefits, but it also has costs and it imposes responsibilities and obligations on the issuer. Each issuer will have to weigh the costs and obligations against the benefits before deciding whether crowdfunding is the "right" solution in its individual circumstances.

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