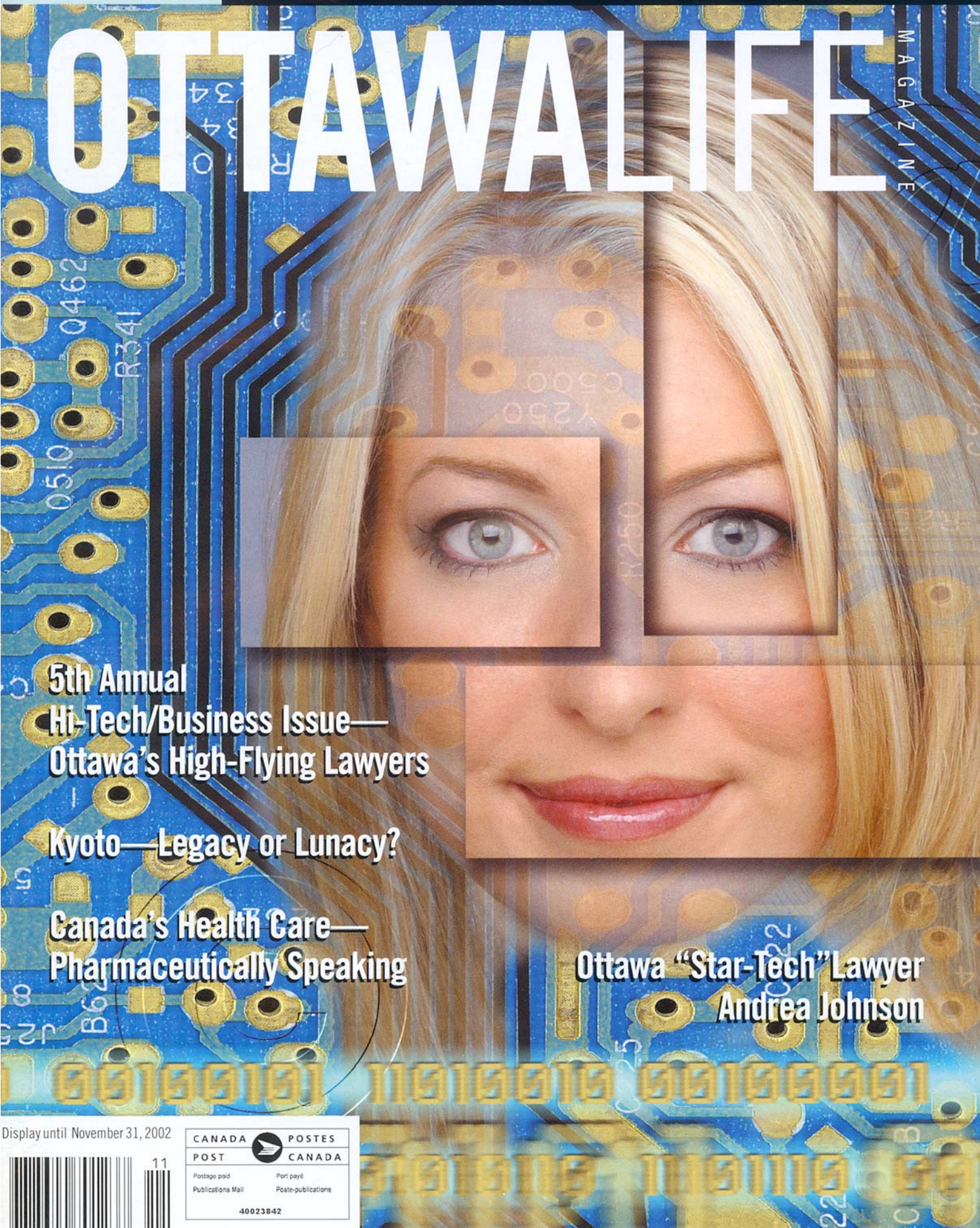


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Ottawa's High-flying Female Lawyers

by Claire Tremblay

Ottawa lawyers have no doubt been hard pressed to see the upside of Ottawa's high-tech gloom and doom. Not only has the volume of business gone down—20 less VC deals passed through the doors of local law firms between 2000 and 2001—but the deals were a lot less lucrative and a lot more nit-picky.

Yet, if nothing else, the tribulations of the last year have shown that Ottawa's high-tech lawyers are made of stern stuff.

Ottawa's high-tech legal eagles have soared. Leading the pack are several high-profile female lawyers — Elizabeth Walker, Virginia Schweitzer, Andrea Johnson and Deborah Weinstein.

Walker, a partner in business law at Osler, Hoskin and Harcourt is a seasoned legal professional and active member of the Ottawa high-tech community. She has been with Osler for 12 years. Walker played an integral role when Osler was chosen as the counsel to JDS and Newbridge with their respective merger deals with Uniphase and Alcatel.

Schweitzer, a senior associate at McCarthy Tétrault, is another one of Ottawa's high-powered legal eagles. Her practice includes corporate finance, securities, licensing and technology law. Schweitzer revels in the complexities of securities law. "I suppose, for some people, it's about as interesting as reading the Canadian Income Tax Act," Schweitzer quips. Her eye for details has seen her chalk up some big successes. Schweitzer acted as co-lead counsel on Corel Corporation's recent acquisitions of Micrografx and SoftQuad and the sale of CrossKeys Systems Corporation to Orchestream Holdings PLC. Her other public company clients include Learnsoft Corporation. In her spare time, she is also involved in the Ontario Bar Association—Young Lawyers Division, National Council of Women and Girl Guides of Canada.



PHOTO BY PAUL COUVRETTE

Johnson, a relative newcomer to the Ottawa high-tech scene, has worked on several leading VC deals in the last 12 months, including the \$88-million second-round financing Innovance Networks deal—not bad for a fourth-year associate. Johnson also played an integral role in the IPO for Intelligent Detection Systems, which closed December 31, 2000.

Johnson's other experience includes financing and mergers and acquisition work for small start-ups to large multinationals and all points in between — from VC financings for up-and-comers like Ottawa-based Optovation Corporation to assisting in JDS Uniphase's US\$18-billion acquisition of E-TEK Dynamics Inc. in July 2000.

For Walker, Schweitzer and Johnson, the glass ceiling (the concept that women are restricted from reaching the heights of their profession by virtue of their sex) doesn't exist. All three say they haven't experienced any discrimination.



(Left to right): Andrea Johnson, Virginia Schweitzer and Monique Couture
Below: Debbie Weinstein on the cover of *Ottawa Life*, October 1997

Ottawa's most successful female lawyer is Debbie Weinstein, founding partner of LaBarge Weinstein. In 1997, we tipped Weinstein as a star on the rise when *Ottawa Life Magazine* featured her on the cover of its inaugural issue. Since then, Weinstein has gone on to bigger and better things. LaBarge Weinstein has been involved in more than \$5 billion worth of venture capital deals, IPOs and M&As. In 2001 alone, it was involved in half the VC deals in the national capital and represented Ottawa's only new Toronto Stock Exchange listing of the year—Adherex Technologies. More recently, Weinstein played an integral role in the acquisition of AiT Corp by 3M earlier this year. Weinstein sits on AiT's board and LaBarge Weinstein acted as the legal counsel for AiT. Who knows what other major transactions the future may hold? ■

The Lawyers: The Changing World of Venture Capital

There was a time in the not-so-distant past when Ottawa high-tech venture capital deals were hastily scrawled on the back of envelopes, most likely in a bar, over a beer.

"Two years ago, venture capitalists were much speedier to close deals. "Some term sheets were literally made on the back of an envelope," says Andrea Johnson, senior associate at law firm Fraser Milner Casgrain (FMC) LLP. Many VCs just wanted business lawyers to put the paper together as quickly as possible and be done with it."

Those were the days when high-tech whiz kids with a hot idea, preferably with the word 'optics' in it, literally had their choice of VC sugar daddies. Lured by the promise of lucrative returns on their investments, angel investors, VCs and banks couldn't hand out wads of cash fast enough.

Then the inevitable happened. The bubble burst and the stock market crash of 2001 sent investors and high-tech companies alike reeling. The bottom fell out of the telecom market and investors singed by the stock market crash recoiled from investing at all, until recently.



Andrea Johnson, senior associate at Fraser Milner Casgrain

So the love affair between venture capitalists and high-tech companies turned sour. Hastily drafted legal documents were replaced by something more onerous. Instead of plunging head-first into an investment, VCs are insisting on the legal equivalent of a carefully worded prenuptial agreement—business term sheets are a non-binding outline of the major terms upon which an investor is prepared to invest in a company, outlining the two main terms for a company going forward: future valuation and control. In short, term sheets determine who gets what, how and when.

While term sheets existed in the heady days of the high-tech boom, they were more of a formality, a piece of annoying paperwork to be churned out to close the deal.

But the hazy days when venture capitalists fell over themselves to scatter millions of

dollars in start-up financing like confetti are well and truly over. And so are the days when lawyers (in Johnson's words) were "viewed as irritants there to simply push the paperwork through."

"It's been like night and day," Johnson says. "When I first started at FMC, you often had to throw the legal documentation together in a matter of days, because investors didn't want to lose the opportunity to invest in a hot company. But now the environment has changed, and VCs are very much calling the shots.

"I think that we are now being seen as a more valuable part of the process, since all parties are more mindful of their risks and liabilities, although lawyers still might be regarded as irritating," Johnson quips.

Johnson, a 30-year-old rising star of Ottawa's high-tech legal scene, has been in a unique position to see the dramatic changes unfold in the industry. (Johnson's area of practice is general corporate and securities law with a concentration on technology and emerging growth companies.) As a young lawyer who began her legal career articling for FMC in 1997, Johnson, a fourth-year associate, has witnessed up close and personal both the heady boom and headache bust of Ottawa's high-tech sector.

In her first six months at FMC, Johnson worked on the IPO for Intelligent Detection Systems Inc., a deal that closed on December 31, 1997. In a striking example of the changes in Ottawa's high-tech sector, the company subsequently failed in early 2001. She also worked with FMC partners Tom Houston and David Little on the investor side for the initial two rounds of financing for Kanata's Extreme Packet Devices Inc. Within months (February 2000), the fabless semi-conductor was acquired by British Columbia-based Internet infrastructure firm PMC-Sierra for \$600 million. Other VC financings Johnson has worked on for FMC in recent years include Meriton Networks Inc., DragonWave Inc., Innovance Networks Inc. and Optovation Corp. These days, however, like most of Ottawa's business lawyers, Johnson's more likely to be struggling over the finer points of a term sheet than closing hundred-million-dollar acquisitions and launching IPOs.

"There's no question that it's less fun these days," Johnson says. "Everyone is under a lot more stress, including the professional advisors."

And Ottawa's high-tech lawyers have collectively suffered. In 2001, there were 53 venture capital deals, compared to 75 in

2000. Only two IPOs made their way out of Ottawa that year – Adherex Technologies and Northland Systems Training.

Making the life of the high-tech lawyer even more difficult are VCs that demand liquidation preferences giving them the right to extract their money before any other shareholder, and anti-dilution clauses that preserve their stake in the company in the face of declining valuations. These rights often come at the expense of the founders and earlier investors. VCs are also engaging in more intense scrutiny of companies prior to investing, insisting on solid indications of customer support of the product and taking longer to make investment decisions.

Also causing acrimony between venture capitalists, founders and angel investors are what FMC partner Houston refers to as "down-rounds"—a subsequent round of financing based on a lower valuation (and share price) than previous rounds.

"When combined with the effect of anti-dilution provisions granted in previous rounds, a down-round can result in a significant reduction in the value of the equity interests held by founders and early-stage investors," says Houston. In industry jargon, this means that other shareholders are being "crammed down" or squeezed.

"They (angel investors and company founders) might have had a 35-per-cent interest in the company prior to the new round of financing, but end up holding two or three per cent of the company," Houston explains.

Johnson says that this has been a big issue for the founders and angel investors who put their blood, sweat and tears into the company. While the effect on founders who continue as employees in the company may be offset to some degree by the granting of new lower-priced stock options, their founder stock and the angel investors will be dramatically affected. The difficulty, however, is that a down-round is often the only financing option that is available—founders are forced to choose between running out of cash, and accepting financing terms that are unfavorable but reflective of prevailing market conditions.

"This is a big issue," Johnson notes. "If early stage investors and angels are getting squeezed, what incentive will they have to invest in new start-ups?"

The views of Johnson and Houston are typical of the legal community at large. Many lawyers are urging their company clients to

by **Claire Tremblay**

bolt down the hatches and hang on for the ride.

Elizabeth Walker, partner in business law at Osler, Hoskin and Harcourt, says the terms of engagement with venture capitalists have become so onerous, she's had to dissuade company clients from signing on the dotted line. Walker has been with Osler for 12 years, practicing corporate and securities law.

"We have certainly provided advice that a particular transaction contains terms that are beyond what is normal and are too onerous," says Walker.

Like many other high-tech lawyers, Walker is spending more time at board meetings, figuring out how to wrestle the best terms for her clients in these tough times.

"It is our responsibility to guide directors through the transaction and provide an assessment of the implications of a particular structure on future operations and financings," Walker says. "We focus mostly on maintaining flexibility for our companies to have their boards and management continue to run the company."

It's a tough call when, in Walker's experience, a company has spent a year looking for

capital and only has one offer on the table to show for it.

Three years ago, it was a different story. Walker says financing transactions were typically no-fuss common-share deals—a purchase agreement and a shareholders' agreement that consisted of minimal legal paperwork. As investors became increasingly savvy, the transactions morphed into complicated preferred share and convertible debt deals. (Osler Hoskin and Harcourt was the legal counsel for two of the largest technology deals in Canadian history: the mergers of JDS and Uniphase and of Newbridge and Alcatel.)

Walker says she's also spending more time "combing through the agreements and background of a company advising VC clients on the status of the company's agreements and the level of protection of its intellectual property."

Clients are being advised to carefully document their company's structure and contractual arrangements to ensure their intellectual property is adequately protected.

"Two years ago, it wasn't unusual to have 'minor warts' overlooked by an eager

investor, as financings were often completed based on an unexecuted business plan or an idea," says Brian McIntomny, partner at Gowlings and head of its Ottawa Technology Industry Group. These warts included incomplete planning with respect to employee recruitment, compensation schemes or distribution channels.

Gowlings Ottawa acted as legal counsel for Terry Matthews in the acquisition of the worldwide telecommunications systems business previously operated by Kanata's Mitel Corporation. These transactions, completed in February 2001, included the acquisition of the Mitel name for a total purchase of \$350 million.

"In the past, we've seen transactions where certain investors were prepared to overlook the lack of a fully-developed business plan," says McIntomny.

Not so these days. The emphasis is strictly on due diligence. A good idea just doesn't cut it anymore.

Fraser Milner Casgrain
partner, Tom Houston





Due diligence, says McIntomny, tends to minimize the risk that someone will be able to wildly overestimate their abilities. Stricter due diligence flows from a number of factors, including the longer time horizons that investors now have and, consequently, that issuers must now have.

"Valuations are also much lower these days, as investors are focusing on what the issuer has actually accomplished, rather than on what potential accomplishments are available to the issuer."

From a VC's perspective, however, such terms are necessary, given the high-tech climate. After all, VCs also need to protect their interests.

"Most VCs were hurt by the downturn in the telecom market and their pain is reflected in the new terms and an element of VC control never before seen," says René Seguin, director of venture capital at the Business Development Bank of Canada (BDC) in Ottawa.

The unexpected bankruptcy of Sedona Networks is a case in point. BDC Venture Capital invested early in Sedona, only to see the company die an early death. Zenastra Photonics was another start-up with promise that folded prematurely.

Seguin says VCs now favor software investments that provide a quick return on investment and later-stage companies that offer investors an element of stability. Biotech has also been a favored area in the last two years, although Seguin says it is being hampered by overcrowding—as was the telecom sector.

Many VCs are placing their bets on technology that will hit the markets in 2003-

04. Catena, Innovance, Ceyba and Tropic Networks are companies that are introducing future technologies using expensive-to-develop copper access and fiber-optic technologies.

"VCs are carefully monitoring the demand in a specific sector before investing, hence the much longer due diligence process involved in today's investments," Seguin observed.

While such caution is understandable, the lag times between financing rounds has caused promising start-ups to die on the table. Take Gatineau-based Internet company NetPCS. In mid-2001, NetPCS boasted 100 employees, 14 million users and a \$6-million VC windfall in its first six months. In May, it flamed out, due to a lack of financing. Months earlier, CEO Paul Nixon had searched for a minimum \$2-million financing round to keep the company afloat. Ironically, NetPCS won the Canadian IT Financing Forum's Investor Choice Award in 2000 as the most promising start-up. With Houston estimating that most start-ups are waiting six to nine months to receive venture capital finance, some start-ups don't even start-up at all.

The uncertain nature of VC financing has prompted the legal community to urge their clients to look at other revenue-raising methods, such as co-development arrangements.

Mark Burton from Stikeman Elliott (Ottawa) recommends clients shop around for term sheets. If the conditions are too onerous, they should skip the VC route altogether. Companies can also sauce up their existing investments, form joint ventures with suppliers and generate revenues from a service they offer, while

waiting for product development funding.

"Many companies are successful in raising venture capital and the mentality often centers around the need to get a venture capitalist who will raise 70% of the money for the company," Burton says.

Start-up companies that don't have a prospect for revenues are also being encouraged to equip themselves with enough funds to last them through the end of the calendar year. This has proven especially important with companies' valuations plunging from funding round to funding round.

The solution for some has been to limit cash burn through staff reduction. And it's not just the Nortels that have taken the axe to their workforces. Innovance Networks, which makes optical network components, cut 27 per cent of its workforce, or 80 people. In 2000, Innovance secured \$145 million in VC funding in two financing rounds. Another round of \$88 million was announced this February.

Another issue that has affected high-tech start-ups is difficulty in planning the future, says Virginia Schweitzer, senior associate with McCarthy Tétrault.

"In the dot-com era, people always saw an exit strategy, such as an IPO or a sell-out in two years' time," Schweitzer says. "Looking long-term was less on people's minds. There is no longer the certainty that there will even be an exit strategy."

Given the vagaries of the market, Schweitzer is advising her clients to ask themselves what their objectives are three or five years from now.

"I ask them questions like: 'If you do a round of financing today, how much of the company do you want to give away and what will that mean for your second and third round if that comes to pass?'"

Schweitzer also points out that VCs don't hold all the cards. Placing impossible terms on high-tech companies seeking finance isn't always in the best interests of the VC. VCs want to get the best return on their funds and that means they want companies to succeed.

"VCs need to create a situation where the company will do well," Schweitzer says. "VCs are working with companies to ensure that, despite tough terms, the company and its founders are well placed to carry on a successful business."

Another result of the high-tech downturn is a change in the way high-tech companies — especially smaller companies — handle their legal affairs.

Robert Lewis, a partner at Lewis Langevin, says in the last two years some high-tech companies have made the switch from big-name law firms to smaller firms to handle their everyday legal affairs. Instead of relying on a specialist from a big-name law firm to take care of routine legal matters, Lewis Langevin and other small law offices have been offering more generalist but considerably less expensive advice.

"With budget and staff being slashed, small tech companies cannot afford to spend a great deal of money on lawyers," says Lewis. "Many are attempting to handle their own legal work — from drafting termination arrangements and simple contracts, to preparing their own patent and trademark applications."

"If a client has a specialist problem, we simply subcontract this piece of work to a trusted specialist lawyer at no additional cost to the client."

Like larger law firms, Lewis Langevin has advised cash-strapped small and medium-sized companies to look beyond VC options for financing. Lewis says the company has been "forced to make some creative payment arrangements with clients in a cash crunch," including taking equity positions in some client companies.

"We are seeing an increase in debt financing and employee stock programs," Lewis says. "In other cases, expansion plans have simply been put on hold because equity financing has become far too expensive."

Despite the bloodletting of the past 18 months, there are indications that the high-tech freeze is due for a thaw.

Ottawa, the Silicon Valley of the North, is still relatively vibrant. In 2000, the height of Ottawa's high-tech boom, the city amassed \$1.3 billion in VC. In 2001, the technology cluster's venture capital total was just shy of this figure at \$1.28 billion. 2002 is also shaping up to be a good year.

A Macdonald and Associates study in May revealed that Ottawa landed \$352 million in VC money in the first three months of 2002. By contrast, companies in the Greater Toronto area attracted only \$23 million.

The nation's capital secured 45% of Canada's and 90% of Ontario's venture capital funds in the first quarter of 2002. Venture capitalists handed over \$385 million to Ottawa's high-tech firms — 10 per cent more than the boom in first-quarter 2000. The bulk of the funds, however, have fallen into the laps of a lucky few. Most of Ottawa's high-tech companies are finding it tough going. Catena Networks received the lion's share at \$120 million. Another \$88 million went to Innovance Networks, \$62.4 million to Silicon Access and \$46 million to Trillium Photonics. All the same, Ottawa is faring way better than the U.S. as a whole, which saw a 71% drop in VC in the past two years.

At the close of second-quarter 2002, Ottawa's top nine high-tech companies brokered more than \$500 million worth of deals. Leading the pack, Borden Ladner Gervais clocked up eight deals worth an estimated \$97 million. Osler Hoskin and Harcourt secured five deals worth \$91 million, while FMC brokered six deals estimated at \$60 to \$105 million.

According to Seguin of BDC, the situation can only get better. VC intransigence won't last forever. Seguin expects that the strenuous demands made by venture capitalists will be phased out within two years.

Adherex Technologies is one of the companies that appears to be leading the high-tech revival in Ottawa. The

small biotechnology company announced in October its plan to buy Oxiquant Inc. of New York for \$18 million in a merger expected to speed up the release of its cancer drugs and attract more investment capital. Adherex's Exherin drug could be in the critical clinical test stage by year's end. Exherin kills cancer cells by stopping them from attaching to organs. Under the merger, Adherex will issue 40 million shares worth 44.5 cents each. The purchase represents a turnaround for the biotech company's 28 staff. Adherex shares fell to a low of 28 cents a share in December 2001 from a high of \$1.19 after its first public offering in June 2001.

There can be no doubting that the future is set to be a lot rosier than the doom days of late 2001.

Osler Hoskin and Harcourt boosted corporate lawyer numbers at its Ottawa office, as has FMC and Stikeman Elliott in anticipation of a new boom time ahead.

"Despite the tech slump, we've been very busy right out of the gate, acting on three or four of the past year's major transactions," says Burton of Stikeman Elliott. "If we can be busy in a slump, then the sky's the limit when the business cycle turns positive again." ■



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