

2003 BCSECCOM 54

Headnote

Mutual Reliance Review System for Exemptive Relief Applications – relief for a labour-sponsored investment fund to make certain payments to participating dealers in connection with a distribution to the public of its securities, subject to certain conditions

Applicable British Columbia Provisions

National Instrument 81-105 – *Mutual Fund Sales Practices* – ss. 2.1 and 9.1

IN THE MATTER OF NATIONAL INSTRUMENT 81-105 MUTUAL FUND SALES PRACTICES

AND

IN THE MATTER OF THE MUTUAL RELIANCE REVIEW SYSTEM FOR EXEMPTIVE RELIEF APPLICATIONS

AND

IN THE MATTER OF CANADIAN MEDICAL DISCOVERIES FUND II INC.

MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the “Decision Maker”) in each of Alberta, British Columbia, Manitoba, Newfoundland, Prince Edward Island, Yukon, Northwest Territories and Nunavut (the “Jurisdictions”) has received an application (the “Application”) from Canadian Medical Discoveries Fund II Inc. (the “Fund”) and Medical Discovery Management Corporation (the “Manager”) for a decision pursuant to section 9.1 of National Instrument 81-105 Mutual Fund Sales Practices (the “NI 81-105”) that the prohibition contained in section 2.1 of NI 81-105 against the making of certain payments by the Fund to participating dealers shall not apply to the Fund;

AND WHEREAS under the Mutual Reliance Review System for Exemptive Relief Applications (the “System”), the Alberta Securities Commission has been designated as the principal regulator for the purposes of this Application;

AND WHEREAS unless otherwise defined, the terms herein have the meaning set out in National Instrument 14-101 Definitions;

AND WHEREAS the Fund and the Manager have represented to the Decision Makers as follows:

2003 BCSECCOM 54

1. The Fund is a corporation resulting from the amalgamation under the laws of Canada of CMDF Venture Fund Inc. and CMDF Early Stage Fund Inc. on August 31, 2002. Both predecessor funds were incorporated under the laws of Canada on October 31, 2001. The head and registered office of the Fund is at 100 International Blvd., Toronto, Ontario, M9W 6J6.
2. The Manager is a corporation incorporated under the laws of Ontario on August 26, 1994 and acts as the manager of the Fund.
3. The Fund is registered as a labour sponsored investment fund corporation under the Community Small Business Investment Funds Act (Ontario) (the "Ontario Act") and as a result of such registration is a prescribed labour sponsored venture capital corporation under the Income Tax Act (Canada) (collectively the "Tax Legislation").
4. The Fund is a mutual fund as defined in the securities legislation of the Jurisdictions and currently distributes securities in Ontario under a prospectus. The Fund filed a preliminary and pro forma prospectus dated November 27, 2002 in Ontario, Quebec and the Jurisdictions (the "Prospectus").
5. The authorized capital of the Fund consists of an unlimited number of Class A Shares, 25,000 Class B Shares and an unlimited number of Class C Shares issuable in series, of which an unlimited number of Class C Shares Series I have been authorized. As at October 31, 2002, the Fund had 620,714.771 Class A Shares and 20 Class B Shares issued and outstanding, and there were no Class C Shares, Series I outstanding.
6. The Fund proposes to pay directly to participating dealers certain costs associated with the distribution of its Class A Shares. These costs are:
 - (i) a sales commission of 6% of the subscription price for each Class A Share subscribed for (the "6% Sales Commission"),
 - (ii) an annual service or trailer fee equal to 0.5% of the average daily net asset value of the Class A Shares held by customers of the sales representatives of the dealers, such fee to be paid quarterly (the "Trailing Commission").
7. The Fund may also, from time to time, enter into co-operative advertising programs with dealers distributing Class A Shares which provide for the reimbursement by the Fund of advertising, mailing and other expenses

2003 BCSECCOM 54

incurred by such dealers in the promotion of Class A Shares (the “Co-op Expenses”).

8. The Prospectus discloses, and the Fund’s final prospectus will disclose, that the Fund will pay directly and is responsible for payment of the costs of distributing its shares, including the 6% Commission, the Trailing Commission and the Co-op Expenses (collectively, the “Distribution Costs”).
9. For accounting purposes, the Fund will:
 - (i) amortize the 6% Sales commission paid or payable by the Fund on a straight line basis to retained earnings over eight years. The 6% Sales Commission is recoverable on a declining basis at the rate of 0.75% per annum, in the event Class A Shares of the Fund are redeemed by the holders thereof prior to the expiry of an eight year period following the purchase thereof.
 - (ii) expense the Trailing Commission and the Co-op Expenses in the fiscal period when incurred and will not defer and amortize any Trailing Commission nor any Co-op Expenses.
10. Gross investment amounts will be paid to the Fund in respect each subscription. This is to ensure that the entire subscription price paid by the investor is counted for the purpose of the applicable federal and provincial tax credits in connection with the purchase of Class A Shares.
11. Due to the structure of the Fund, the most tax efficient way for the Distribution Costs to be financed is for the Fund to pay them directly.
12. The Manager is capitalized only to the extent necessary for its operations, and is dependent on management fee revenue derived from the Fund and the other labour sponsored investment fund managed by it for the purpose of satisfying its ongoing obligations. As a result, the Manager does not have sufficient resources to pay the Distribution Costs and, unless the requested discretionary relieve is granted, would be obliged to finance these costs through borrowings.
13. Any loans obtained by the Manager to finance the Distribution Costs would result in the Manager needing to renegotiate its management fee to increase the management fee chargeable to the Fund, by an amount equal to the borrowing costs incurred by the Manager plus an amount required to compensate the Manager for any risks associated with fluctuations in the net asset value of the Fund and, therefore, fluctuations in the Manager’s fee.

2003 BCSECCOM 54

Requiring compliance with Section 2.1 of NI 81-105 would cause the expenses of the Fund to increase above those contemplated in the Prospectus.

14. Requiring the Manager to pay the Distribution Costs while granting an exemption to other labour funds permitting such funds to pay similar Distribution Costs directly, would put the Fund at a permanent and serious competitive disadvantage with its competitors.
15. The Fund and the Manager undertake to comply with all other provisions of NI 81-105. In particular, the Fund undertakes that all Distribution Costs paid by it will be compensation otherwise permitted to be paid to participating dealers under NI 81-105.

AND WHEREAS under the System, this MRRS Decision Document evidences the decision of each Decision Maker (collectively, the “Decision”);

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the securities legislation in the Jurisdictions (the “Legislation”) that provides the Decision Maker with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers under the Legislation is that, pursuant to section 9.1 of the National Instrument, the Fund is exempted from section 2.1 of the NI 81-105 to permit the Fund to pay directly the Distribution Costs, provided that:

- (a) the Distribution Costs are otherwise permitted by, and paid in accordance with, NI 81-105;
- (b) the Distribution Costs are accounted for in the Fund’s financial statements in the manner described in paragraph 8 above;
- (c) the summary section of the final prospectus explains clearly to investors that:
 - (i) they pay the 6% Sales Commission indirectly, as the Fund pays the 6% Sales Commission using investors’ subscription proceeds, and
 - (ii) the services and value that the participating dealers would provide to their clients who are Class A shareholders of the Fund in return for the Trailing Commission payable by the Fund to the dealers, and

2003 BCSECCOM 54

- (iii) a portion of the net asset value of the Fund is comprised of a deferred commission, rather than an investment asset; and

this summary section must be placed within the first 10 pages of the final prospectus.

- (d) this Decision shall cease to be operative with respect to a Decision Maker on the date that a rule replacing or amending section 2.1 of NI 81-105 comes into force.

DATED at Calgary, Alberta this 9th day of January 2003.

(Ken Parker, Director, Capital Markets)