

2006 BCSECCOM 132

February 22, 2006

Headnote

Mutual Reliance Review System for Exemptive Relief Applications - National Instrument 51-102, s. 13.1 - Continuous Disclosure Obligations - Information circular - An issuer wants relief from the requirement to include prospectus-level disclosure in an information circular to be circulated in connection with an arrangement, reorganization, acquisition or amalgamation - The reporting issuer's business collapsed because of actions of the vendors of the business; as a result of the collapse, the issuer's auditors withdrew their audit report on the issuer's historical financial statements, and provided a qualified audit report in respect of the issuer's most recent annual financial statements; the issuer has no active business since the collapse; issuer is attempting to restructure by way of a reverse takeover and depart entirely from its previous business; circular will provide information about the collapse, the restructuring, and the financial information that is available; the circular will include the financial disclosure about the other party to the reverse takeover that would be required in a prospectus, except pro forma financial information that cannot be provided because of the deficiencies in the issuer's financial record

National Instrument 52-107, s. 9.1 - Acceptable Accounting Principles, Auditing Standards and Reporting Currency - An issuer wants to prepare and send a management information circular to its shareholders, in connection with a merger, continuation, arrangement, or reorganization, without providing financial statements that are accompanied by an auditor's report that does not contain a reservation - As a result of the collapse of the issuer's business, the issuer's auditors provided a qualified audit report in respect of the issuer's most recent annual financial statements - The issuer has no active business since the collapse; the qualified audit report was not due to a departure from accounting principles permitted by NI 52-107 or due to a limitation in the scope of examination by the auditors that resulted in them being unable to form an opinion on the financial statements as a whole, was imposed or could have reasonably been eliminated by management, or could reasonably be expected to be recurring; issuer is attempting to restructure by way of a reverse takeover and depart entirely from its previous business; circular will provide information about the collapse, the restructuring, and the financial information that is available

National Instrument 45-106, s.7.1 - Prospectus and Registration Exemptions - An issuer wants relief from the requirement to deliver an offering memorandum in the required form - The issuer's business collapsed because of actions of the vendors of the business - As a result of the collapse, the issuer's auditors withdrew their audit report on the issuer's historical financial statements, and provided a qualified audit report in respect of the issuer's most recent annual financial statements; the

2006 BCSECCOM 132

issuer has no active business since the collapse; issuer is attempting to restructure by way of a reverse takeover and financing, which will result in it departing entirely from its previous business; the offering memorandum will provide information about the collapse, the restructuring, and the financial information that is available; the offering memorandum will include the financial disclosure about the resulting entity that would be required in a prospectus, except pro forma financial information that cannot be provided because of the deficiencies in the issuer's financial record

Applicable British Columbia Provisions

Securities Act, R.S.B.C. 1996, c. 418, s. 119

National Instrument 51-102, ss. 9.1 and 13.1

Form 51-102F5, Item 14.2

National Instrument 52-107, ss. 3.1 and 9.1

National Instrument 45-106, ss. 2.9, 6.6 and 7.1

Form 45-106F2

In the Matter of
the Securities Legislation of
Alberta and British Columbia

and

In the Matter of
the Mutual Reliance Review System for Exemptive Relief Applications

and

In the Matter of
Dragon-Tex (Group) Limited (DT),
Med BioGene Inc. (MBG) and 0731159 B.C. Ltd. (Newco 1)

MRRS Decision Document

Background

1. The local securities regulatory authority or regulator (the Decision Maker) in each of Alberta and British Columbia (the Jurisdictions) has received an application from DT, MBG and Newco 1 for a decision under the securities legislation of the Jurisdictions (the "Legislation") for an exemption from the requirement that the:
 - 1.1 proposed joint management information circular (the Joint Circular) of DT and MBG providing disclosure relating to the Transactions (as

2006 BCSECCOM 132

defined below) include financial statement disclosure relating to DT, and pro forma financial statement disclosure giving effect to the Transactions, in accordance with Form 51-102F5 and that these financial statements be accompanied by an auditor's report without a reservation in opinion in accordance with National Instrument 52-107 *Acceptable Accounting Principles, Auditing Standards and Reporting Currency*; and

- 1.2 proposed offering memorandum (Offering Memorandum) of Newco 1 to be used in conjunction with the Newco 1 Private Placement (as defined below), and wrapped around the Joint Circular, provide financial statement disclosure relating to DT, and pro forma financial statement disclosure giving effect to the Transactions, in accordance with Form 45-106F2

(collectively, the "Requested Relief").

2. Under the Mutual Reliance Review System for Exemptive Relief Applications:
 - 2.1 the Alberta Securities Commission is the principal regulator for this application; and
 - 2.2 this MRRS decision document evidences the decision of each Decision Maker.

Interpretation

3. Defined terms contained in National Instrument 14-101 *Definitions* and National Instrument 51-102 *Continuous Disclosure Obligations* have the same meaning in this decision unless they are defined in this decision.

Representations

4. This decision is based on the following facts represented by DT, MBG and Newco 1:
 - 4.1 DT was incorporated under the *Business Corporations Act* (Alberta) on April 25, 2002 under the name CJHC Capital Ltd. On January 5, 2004, DT changed its name from CJHC Capital Ltd. to Dragon-Tex (Group) Limited;
 - 4.2 On January 6, 2004, DT completed a qualifying transaction with the acquisition of all of the issued and outstanding shares of South Champ Trading Limited ("South Champ") in exchange for the issuance of DT

2006 BCSECCOM 132

common shares. South Champ is a limited liability company registered under the Companies Ordinance (Chapter 32) in Hong Kong on June 27, 1996;

- 4.3 DT has no active business operations. Prior to the last three months of 2004, DT's principal business was the manufacture of woven fabrics, including cotton, twill, corduroy and denim together with the trading of cotton yarn products and children's apparel through its wholly-owned subsidiary, South Champ, operating in Hong Kong, Macau and the Peoples Republic of China;
- 4.4 South Champ effectively ceased to operate during the last three months of 2004. South Champ and its directors are being sued by a number of creditors in Hong Kong for delinquency of debt repayment. The management of South Champ did not disclose to DT prior to the qualifying transaction that South Champ was a shareholder of several private companies and had provided liability guarantees on behalf of some of these companies prior to the closing of the qualifying transaction;
- 4.5 Due to action taken by its creditors, South Champ's manufacturing facilities have been shut down and its equipment seized. DT has been unable to obtain access to the accounting records of South Champ since the quarter ended September 30, 2004. The board of directors of DT, in the absence of additional information, has determined a nominal value of \$1 for its investment in South Champ;
- 4.6 Effective December 19, 2005, DT sold to Legend High Enterprises Limited, an arm's length third party, all of the shares of South Champ, being all or substantially all of the assets of DT, for an aggregate price of \$1. The sale of the South Champ shares is subject to the condition subsequent that the DT shareholders ratify the sale on or before July 31, 2006;
- 4.7 DT is a reporting issuer in Alberta and British Columbia;
- 4.8 DT's common shares are listed on the TSX Venture Exchange ("TSXV"), but trading in DT common shares has been suspended as a result of cease trade orders in effect in the Jurisdictions (the "Cease Trade Orders");
- 4.9 DT is concurrently seeking from the Jurisdictions a partial variation of the Cease Trade Orders to permit for, among other things, trades in

2006 BCSECCOM 132

DT common shares in order to give effect to the Transactions (as defined below);

- 4.10 DT's annual audited financial statements as at and for the year ended March 31, 2004 and the accompanying management's discussion and analysis were filed on SEDAR on August 18, 2004, and these financial statements were revised and filed on SEDAR on August 19, 2004 (the financial statements being, the "DT 2004 Annual Financial Statements");
- 4.11 Effective January 5, 2006, DT's auditors, Maldaner Crooks Watson of Calgary, Alberta ("DT's Auditors"), withdrew its auditor's report dated August 16, 2004 on the DT 2004 Annual Financial Statements. This withdrawal was due to the events that occurred subsequent to the issuance of the DT 2004 Annual Financial Statements with respect to South Champ as described in paragraphs 4 and 5. DT's Auditors determined that the DT 2004 Annual Financial Statements were not in accordance with Canadian generally accepted accounting principles because they did not contain disclosure regarding certain guarantees and investments relating to South Champ's activities. Further, DT's Auditors had placed reliance on representations made by South Champ's management regarding its activities. Given the circumstances outlined in this paragraph 11 and the loss of confidence in South Champ's management, DT's Auditors concluded that such reliance was no longer appropriate.
- 4.12 On January 10, 2006, in light of the withdrawal by DT's Auditors of its auditor's report on the DT 2004 Annual Financial Statements, management of DT, with the approval of the board of directors of DT, withdrew its management report on the DT 2004 Annual Financial Statements;
- 4.13 DT filed a material change report on SEDAR on January 13, 2006 in respect of the matters described in paragraphs 11 and 12;
- 4.14 The financial statements of DT as at and for the year ended March 31, 2005 (the "DT 2005 Annual Financial Statements") and the accompanying management's discussion and analysis were filed on SEDAR on January 11, 2006, and DT's interim unaudited financial statements for the three and six months ending June 30, 2005 and September 30, 2005, respectively, and the accompanying management's discussion and analysis were filed on SEDAR on January 26, 2006 (the "DT Interim Financial Statements");

2006 BCSECCOM 132

- 4.15 DT's Auditors were unable to examine the books and records of South Champ for the year ended March 31, 2005 due to the loss of control by DT over South Champ and the failure of South Champ. Accordingly, DT's Auditors were unable to determine whether revenues, expenses and cash flows in the DT 2005 Annual Financial Statements have been recorded properly, and whether any adjustment might be necessary to the statements of loss, deficit and cash flows, as well as to the accompanying notes. Therefore, the auditor's report on the DT 2005 Annual Financial Statements was qualified (the "DT 2005 Qualified Auditor's Report"). The DT 2005 Qualified Auditor's Report was not:
- 4.15.1 due to a departure from accounting principles permitted by National Instrument 52-107; or
 - 4.15.2 due to a limitation in the scope of examination by DT's Auditors that:
 - 4.15.2.1 resulted in DT's Auditors being unable to form an opinion on the DT 2005 Annual Financial Statements as a whole;
 - 4.15.2.2 was imposed or could have reasonably be eliminated by management; or
 - 4.15.2.3 could reasonably be expected to be recurring;
- 4.16 DT is in default of National Instrument 52-107 as a result of the DT 2004 Annual Financial Statements and DT 2005 Annual Financial Statements not being accompanied by an auditor's report without qualification;
- 4.17 MBG was incorporated under the *Company Act* (British Columbia) on October 16, 2002. On July 20, 2005, MBG transitioned to the *Business Corporations Act* (British Columbia). MBG is not a reporting issuer or its equivalent in any of the provinces or territories of Canada;
- 4.18 MBG has two wholly-owned subsidiaries: Newco 1 and 1185412 Alberta Ltd. ("Newco 2"), both of which were incorporated to facilitate the Transactions (as defined below). Neither Newco 1 nor

2006 BCSECCOM 132

Newco 2 are reporting issuers or its equivalent in any of the provinces or territories of Canada;

4.19 The Joint Circular will be furnished to the DT shareholders and MBG shareholders in conjunction with the solicitation of proxies by and on behalf of management of DT and MBG in connection with special meetings of shareholders of DT and MBG, respectively, called to consider and, if deemed fit, pass a special resolution approving, among other things:

4.19.1 as contemplated in the amended and restated amalgamation agreement dated January 16, 2006 among DT, MBG and Newco 2, the combination of DT and MBG by way of the amalgamation (the “DT Amalgamation”) of DT and Newco 2;

4.19.2 as contemplated in the amended and restated amalgamation agreement dated January 16, 2006 between MBG and Newco 1, the amalgamation (the “MBG Amalgamation”) of MBG and Newco 1 (the amalgamated company resulting from the MBG Amalgamation being, “Amalco 1”),

and, upon closing of the DT Amalgamation and the MBG Amalgamation (collectively, the “Amalgamations”), the DT shareholders and MBG shareholders will become Amalco 1 shareholders, and it is expected that the Amalco 1 common shares will be listed on, and the DT common shares will be de-listed from, the TSXV, subject to stock exchange approval;

4.19.3 the private placement by Newco 1 (the “Newco 1 Private Placement”), to be completed immediately prior to the DT Amalgamation. The subscribers to the Newco 1 Private Placement will, upon closing of the MBG Amalgamation, become Amalco 1 shareholders; and

4.19.4. ratifying the sale by DT to Legend High Enterprises Limited of all of the shares of South Champ for an aggregate price of \$1. The sale of the South Champ shares is subject to the condition subsequent that the DT shareholders ratify the sale on or before July 31, 2006

(collectively, the “Transactions”);

2006 BCSECCOM 132

- 4.20 Of the 17,659,933 DT common shares outstanding as of January 27, 2006, DT is seeking judicial and regulatory approval for the cancellation prior to closing of the Amalgamations of 7,933,133 DT common shares held by the original shareholders of South Champ;
- 4.21 In accordance with Form 51-102F5, the Joint Circular is required to include the disclosure (including financial statement disclosure) prescribed by the form of prospectus for the entity that would result from the restructuring transaction, and is also required to include pro forma financial statement disclosure giving effect to the Transactions. The Amalgamations will constitute a restructuring transaction. Financial statements included in the Joint Circular are required to be prepared in accordance with Canadian generally accepted accounting principles as applicable to public enterprises in accordance with National Instrument 52-107;
- 4.22 The Joint Circular will contain prospectus-level disclosure of the business and affairs of DT, MBG, Newco 1 and Newco 2 and of the particulars of the Transactions;
- 4.23 It is proposed that the Joint Circular include in respect of DT the audited consolidated balance sheet as at March 31, 2005 (the “DT 2005 Audited Balance Sheet”) from the DT 2005 Audited Financial Statements, in addition to the DT Interim Financial Statements;
- 4.24 The DT 2005 Audited Balance Sheet will be accompanied by the DT 2005 Qualified Auditor’s Report;
- 4.25 It is proposed that the Joint Circular include a pro forma balance sheet of Amalco 1 as at the date of MBG’s most recent balance sheet included in the Joint Circular, being September 30, 2005, giving effect to the Transactions as if they had taken place as at this date (the “Amalco 1 Pro Forma Balance Sheet”);
- 4.26 The Offering Memorandum is required to provide financial statement disclosure relating to DT, and pro forma financial statement disclosure giving effect to the Transactions, in accordance with Form 45-106F2. The Offering Memorandum will satisfy such requirements if it provides financial statement disclosure required by securities legislation for a prospectus;
- 4.27 It is proposed that the Offering Memorandum be wrapped around the Joint Circular in accordance with Form 45-106F2, and that the

2006 BCSECCOM 132

financial statement disclosure provided in the Joint Circular be the only financial statement disclosure provided in the Offering Memorandum.

Decision

5. Each of the Decision Makers is satisfied that the test contained in the Legislation that provides the Decision Maker with the jurisdiction to make the decision has been met.
6. The decision of the Decision Makers under the Legislation is that the Requested Relief is granted provided that:
 - 6.1 The Joint Circular:
 - 6.1.1 include the DT 2005 Audited Balance Sheet together with the related notes thereto and the DT 2005 Qualified Auditor's Report;
 - 6.1.2 include the DT Interim Financial Statements;
 - 6.1.3 include the Amalco 1 Pro Forma Balance Sheet; and
 - 6.1.4 otherwise complies with the Legislation; and
 - 6.2 The Offering Memorandum:
 - 6.2.1 be wrapped around the Joint Circular; and
 - 6.2.2 otherwise complies with the Legislation.

Agnes Lau
Associate Director, Corporate Finance
Alberta Securities Commission