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### Headnote

An issuer's securities are converted into or redeemed for securities of another issuer - The investor could have acquired the underlying securities directly from the other issuer in compliance with the registration and prospectus requirements of the Act at the time the investor acquired the convertible securities from the issuer

### Exemption Order

#### **Aquinox Pharmaceuticals Inc. and Aquinox Pharmaceuticals (US) Inc.**

#### **Sections 48 and 76 of the *Securities Act*, R.S.B.C. 1996, c. 418**

### Background

- ¶ 1 Aquinox Pharmaceutics Inc. (Aquinox Canada) and Aquinox Pharmaceuticals (US) Inc. (Aquinox US) (collectively, the Filers) applied for an exemption under sections 48 and 76 of the *Securities Act* (British Columbia) (the Act) from the dealer registration requirement and prospectus requirements under Sections 34(1) and 61 of the Act (the Prospectus and Registration Requirements) relating to trades of certain exchangeable shares and the granting of certain related options in securities made in connection with or resulting from a proposed reorganization of Aquinox Canada and subsequent Series A round financing of Aquinox Canada and Aquinox US (the Requested Relief).

### Representations

- ¶ 2 The Filers represent that:
1. Aquinox US is incorporated under the laws of Delaware and is not a reporting issuer (or equivalent) in any jurisdiction in Canada;
  2. the shares of Aquinox US are not publicly traded, and transfer of its shares is restricted;
  3. the authorized capital of Aquinox US consists of common stock and preferred stock divided into five series, including series A-1 and A-2 preferred stock (collectively the Series Preferred Stock) and series A-1 and A-2 and common special voting stock (collectively the Special Voting Stock);
  4. Aquinox Canada is incorporated under the Canada Business Corporations Act, and is not a reporting issuer (or equivalent) in any jurisdiction in Canada;
  5. the shares of Aquinox Canada are not publicly traded;

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6. Aquinox Canada's authorized capital is an unlimited number of:
  - (a) common shares (Aquinox Canada Common Shares) of which 5,793,776 are issued and outstanding; and
  - (b) class A preferred shares, issuable in series (Aquinox Canada Preferred Shares), of which none are issued and outstanding;
7. Aquinox Canada will have 31 shareholders prior to completing the reorganization;
8. after the reorganization is completed, Aquinox Canada and Aquinox US will be mirrored corporations such that their securityholders will have equivalent voting rights in both corporations;
9. the reorganization will be effected by:
  - (a) amending the articles of Aquinox Canada to create the following:
    - (i) ten new common shares;
    - (ii) unlimited common exchangeable shares (Common Exchangeable Shares);
    - (iii) unlimited class A preferred exchangeable shares issuable in series (the Preferred Exchangeable Shares);
    - (iv) unlimited special voting shares (Special Voting Shares); and
    - (v) unlimited non-voting preferred shares,

(Common Exchangeable Shares and Preferred Exchangeable Shares are collectively referred to as the Exchangeable Shares);
  - (b) changing all of the issued and outstanding Aquinox Canada Common Shares into Common Exchangeable Shares and Special Voting Shares on the basis of one Aquinox Canada Common Share being exchanged for one Common Exchangeable Share and one Special Voting Share; and
  - (c) deleting and cancelling the authorized and unissued Aquinox Canada Common Shares and Aquinox Canada Preferred Shares as classes of shares (including all series);

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10. each Aquinox Canada shareholder will be required to purchase from Aquinox US, for nominal consideration, one share of Special Voting Stock for each Common Exchangeable Share received under the exchange;
11. Aquinox Canada has outstanding incentive stock options granted under its stock option plan (the Aquinox Canada Plan) entitling holders to purchase up to 1,255,000 Aquinox Canada Common Shares;
12. Aquinox Canada will amend the Aquinox Canada Plan to provide for a joint Aquinox US - Aquinox Canada stock option plan (the Joint Aquinox US - Aquinox Canada Plan) under which optionees will be entitled to purchase units consisting of one Common Exchangeable Share and one Special Voting Share and, under the support agreement described in paragraph 25 below, one share of Special Voting Stock, or, if all of the Exchangeable Shares that have been issued have been redeemed or acquired by Aquinox US, one share of common stock of Aquinox US;
13. existing options governed by the Aquinox Canada Plan will be replaced with options governed by the Joint Aquinox US - Aquinox Canada Plan;
14. Aquinox US will separately adopt an Aquinox US stock option plan (the Aquinox US Affiliate Plan) under which optionees will be entitled to purchase one share of common stock of Aquinox US and, under the support agreement described in paragraph 25 below, one Special Voting Share, or, if all of the Exchangeable Shares that have been issued have been redeemed or acquired by Aquinox US, one share of common stock of Aquinox US;
15. Aquinox Canada and Aquinox US are not affiliated as that term is defined in National Instrument 45-106 *Prospectus and Registration Exemptions*;
16. certain investors (the Series A Investors) are proposing to provide up to approximately US\$15.5 million of financing to Aquinox Canada and Aquinox US in two separate tranches;
17. the Series A Investors may choose to receive units consisting of either:
  - (a) one series A-1 Exchangeable Share, one Special Voting Share and one share of Series A-1 Special Voting Stock on the first tranche and units consisting of one series A-2 Exchangeable Share, one Special Voting Share and one share of Series A-2 Special Voting Stock on the second tranche; or

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- (b) one share of Series A-1 Preferred Stock and one Special Voting Share on the first tranche and units consisting of one share of Series A-2 Preferred Stock and one Special Voting Share on the second tranche;
- 18. on completing the Series A Financing, Aquinox US will purchase one new common share of Aquinox Canada;
- 19. the holders of Common Exchangeable Shares will have voting and economic rights which will be, as nearly as practicable, equivalent to the holders of shares of common stock of Aquinox US;
- 20. the holders of Preferred Exchangeable Shares will have voting and economic rights which will be, as nearly as practicable, equivalent to the holders of the corresponding series of Series Preferred Stock;
- 21. Aquinox US or a subsidiary (other than Aquinox Canada), will have overriding call rights to purchase up to all of the outstanding Common Exchangeable Shares and Preferred Exchangeable Shares in exchange for shares of common stock or the corresponding series of Series Preferred Stock of Aquinox US, as applicable, using predetermined calculations (including amounts for any declared and unpaid dividends):
  - (a) on liquidation, dissolution or winding up of Aquinox Canada;
  - (b) on exercise of a retraction right by a holder of Common Exchangeable Shares;
  - (c) on exercise of a retraction right by a holder of Preferred Exchangeable Shares;
  - (d) on exercise of a redemption right by Aquinox Canada to redeem all the Common Exchangeable Shares; or
  - (e) on exercise of a redemption right by Aquinox Canada to redeem all the Preferred Exchangeable Shares;
- 22. subject to the overriding call rights of Aquinox US or its subsidiary, a holder of Common Exchangeable Shares will be entitled to receive shares of common stock of Aquinox US from Aquinox Canada and a holder of Preferred Exchangeable Shares will be entitled to receive shares of the corresponding series of Series Preferred Stock of Aquinox US from Aquinox Canada, using predetermined calculations (including amounts for any declared and unpaid dividends):

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- (a) on liquidation, dissolution or winding-up of Aquinox Canada; or
  - (b) on exercise of the retraction right by the holder;
23. subject to the overriding call rights of Aquinox US or its subsidiary, Aquinox Canada will be entitled to redeem all the Common Exchangeable Shares and Preferred Exchangeable Shares then outstanding at any time on the occurrence of particular events so that holders of Common Exchangeable Shares will receive shares of common stock of Aquinox US from Aquinox Canada and holders of Preferred Exchangeable Shares will receive shares of the corresponding series of Series Preferred Stock of Aquinox US from Aquinox Canada using predetermined calculations (including amounts for any declared and unpaid dividends);
24. Aquinox Canada, Aquinox US and the shareholders of the companies will enter into an exchange agreement, which will provide:
- (a) each holder of Common Exchangeable Shares and Preferred Exchangeable Shares with an exchange right (the Optional Exchange Right), exercisable on the insolvency of Aquinox Canada or the failure of Aquinox Canada to pay the amounts payable on retraction of the Common Exchangeable Shares and Preferred Exchangeable Shares to require Aquinox US to purchase all or part of the holder's:
    - (i) Common Exchangeable Shares in exchange for shares of common stock of Aquinox US; and
    - (ii) Preferred Exchangeable Shares in exchange for shares of the corresponding series of Series Preferred Stock of Aquinox, using predetermined calculations (including amounts for declared and unpaid dividends);
  - (b) that, on the liquidation, dissolution or winding-up of Aquinox US, Aquinox US will purchase all outstanding Common Exchangeable Shares and Preferred Exchangeable Shares and each holder of such shares will sell such shares to Aquinox US:
    - (i) in the case of Common Exchangeable Shares, in exchange for shares of common stock of Aquinox US; and
    - (ii) in the case of Preferred Exchangeable Shares, in exchange for shares of the corresponding series of Series Preferred Stock of Aquinox US,

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using predetermined calculations (including amounts for declared and unpaid dividends) (the Automatic Exchange Right);

25. Aquinox Canada and Aquinox US will enter into a support agreement where, among other things:

- (a) Aquinox US will not declare dividends on shares of common stock or Series Preferred Stock unless Aquinox Canada simultaneously declares equivalent dividends on the Common Exchangeable Shares or the corresponding series of Preferred Exchangeable Shares, as the case may be;
- (b) Aquinox US will ensure that Aquinox Canada is able to fulfill its obligations in respect of redemption and retraction rights and dissolution entitlements; and
- (c) except in certain circumstances, Aquinox US will not undertake certain rights offerings or share capital alterations unless the same or an economically equivalent offering or alteration is undertaken by Aquinox Canada, and vice versa;

26. there are exemptions from the Registration and Prospectus Requirements or exemption orders available for the trades to effect the reorganization;

27. there are no exemptions from the Registration and Prospectus Requirements for possible trades in securities relating to Common Exchangeable Shares, Preferred Exchangeable Shares and securities received under the following exchange rights:

- (a) trades of common stock or Series Preferred Stock of Aquinox US by Aquinox US or, if applicable, trades of such shares by a subsidiary of Aquinox US or Aquinox Canada (and such required trades or transfers by Aquinox US to a subsidiary and to Aquinox Canada) on:
  - (i) the liquidation, dissolution or winding-up of Aquinox Canada;
  - (ii) the exercise of the overriding call rights by Aquinox US or its subsidiary;
  - (iii) a holder's retraction of Common Exchangeable Shares or Preferred Exchangeable Shares;

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- (iv) the redemption of Common Exchangeable Shares or Preferred Exchangeable Shares by Aquinox Canada; and
    - (v) the exercise of the Optional Exchange Right or the occurrence of the Automatic Exchange Right;
  - (b) the transfer of Common Exchangeable Shares or Preferred Exchangeable Shares to Aquinox Canada on:
    - (i) the liquidation, dissolution or winding-up of Aquinox Canada; and
    - (ii) the holder's retraction of Common Exchangeable Shares or Preferred Exchangeable Shares;
  - (c) the transfer of Common Exchangeable Shares or Preferred Exchangeable Shares by the holder to Aquinox US (or a subsidiary of Aquinox US) on exercise of the overriding call rights by Aquinox US or its subsidiary; and
  - (d) the transfer of Common Exchangeable Shares or Preferred Exchangeable Shares by the holder to Aquinox US on exercise of the Optional Exchange Right or the occurrence of the Automatic Exchange Right,
- (collectively, the Exchangeable Share Trades);
28. the Exchange Agreement will also provide for the following options (the Equivalency Options):
- (a) options granted by each holder of Special Voting Stock to Aquinox US to purchase Special Voting Stock from the holder for nominal consideration;
  - (b) options granted by each holder of Special Voting Shares to Aquinox Canada to purchase Special Voting Shares from the holder for nominal consideration; and
  - (c) options granted by Aquinox Canada to each holder of Special Voting Shares to purchase Special Voting Shares for nominal consideration,
- in each case to align the number of shares of Special Voting Stock or Special Voting Shares held with the number of shares of common stock of Aquinox US that the holder would hold if all of the Exchangeable Shares of Aquinox Canada and Series Preferred Stock of Aquinox US held by such holder were exchanged or converted into shares of common stock of Aquinox US; and

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29. as a result of the exchangeable share structure, discretionary relief is necessary for:

- (a) the issuance of Special Voting Stock of Aquinox US under the support agreement upon the exercise of options under the Joint Aquinox US - Aquinox Canada Plan;
  - (b) the issuance of Special Voting Shares of Aquinox Canada under the support agreement upon the exercise of options under the Aquinox US Affiliate Plan; and
  - (c) the granting of the Equivalency Options,
- (collectively, the Option Trades).

### **Order**

¶ 3 Considering that it is not prejudicial to the public interest, the Commission orders that the Requested Relief is granted in respect of the Exchangeable Share Trades and the Option Trades, provided that the first trade of a security acquired under this decision is a distribution unless the first trade complies with Section 2.5 of National Instrument 45-102 *Resale of Securities* (NI 45-102), subject to Section 2.7 of NI 45-102, if applicable.

¶ 4 June 7, 2007

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