

2005 BCSECCOM 131

February 25, 2005

Headnote

Mutual Reliance Review System for Exemptive Relief Applications - Securities Act, s. 48,76- Other - Exemption from s. 34(1)(a) requirement to be registered as a dealer for a trade and s.61 requirement to file a prospectus for a distribution other than in connection with a corporate acquisition or reorganization; business associates; debt settlements; or employee plans and consultants - Trades in securities of another issuer by a partnership to its partners - The trade is being undertaken solely for tax benefits for the partners; the partners could have acquired the securities directly without an exemption order; the partners were aware of the intended trades prior to becoming a partner

Applicable British Columbia Provisions

Securities Act, R.S.B.C. 1996, c. 418, ss. 34(1)(a), 48, 61 and 76
Multilateral Instrument 45-102 Resale of Securities

In the Matter of
the Securities Legislation
of British Columbia, Alberta, Saskatchewan, Manitoba, Ontario, New Brunswick,
Nova Scotia, Prince Edward Island and Newfoundland and Labrador
(the Jurisdictions)

and

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

and

In the Matter of Qwest Energy 2005 Flow-Through Limited Partnership (the Filer)

MRRS Decision Document

Background

- ¶ 1 The local securities regulatory authority or regulator (the Decision Maker) in each of the Jurisdictions has received an application from the Filer for a decision under the securities legislation of the Jurisdictions (the Legislation) that the registration requirement and prospectus requirement in the Legislation (the Registration and Prospectus Requirements) do not apply to the first trade of Warrants (defined below) by the Filer to the limited partners (the Limited Partners) of the filer (the Non-Exempt Trades).

2005 BCSECCOM 131

Under the Mutual Reliance Review System for Exemptive Relief Applications

- (a) the British Columbia Securities Commission is the principal regulator for this application, and
- (b) this MRRS decision document evidences the decision of each Decision Maker.

Interpretation

- ¶ 2 Defined terms contained in National Instrument 14-101 *Definitions* have the same meaning in this decision unless they are defined in this decision.

Representations

- ¶ 3 This decision is based on the following facts represented by the Filer:
1. the Filer is a limited partnership formed under the laws of British Columbia on December 22, 2004 under the *Partnership Act* (British Columbia) to provide Limited Partners with a tax-assisted investment in a diversified portfolio of flow-through shares issued by resource issuers whose principal business is oil and gas/mineral exploration, development and/or production or energy generation, with a view to achieving capital appreciation and profits;
 2. the Filer's head office is located in British Columbia;
 3. the Filer is authorized to issue an unlimited number of limited partnership units (the Units), of which one Unit is currently issued and outstanding;
 4. the Filer is not currently a reporting issuer or the equivalent in any jurisdiction in Canada;
 5. Qwest Energy 2005 Flow-Through Management Corp. (the General Partner) is the general partner of the Filer and manages the business and affairs of the Filer;
 6. the Filer is conducting a financing in the Jurisdictions by way of an initial public offering under a prospectus filed in the Jurisdictions;
 7. in traditional flow-through limited partnership unit offerings (Traditional Flow-Through Offerings), a limited partnership is organized to invest in flow-through shares issued by resource issuers which are usually listed on a Canadian stock exchange and whose principal business is oil and gas/mineral exploration, development and/or production or energy generation; such Traditional Flow-Through Offerings are usually blind pool offerings;

2005 BCSECCOM 131

8. following the closing of a Traditional Flow-Through Offering, the limited partnership will enter into agreements to subscribe for common shares from the treasury of resource issuers (Resource Cos) under flow through investment subscription agreements (the Flow-Through Agreements); under the Flow-Through Agreements, each Resource Co in question will typically incur and renounce Canadian Exploration Expense (CEE) or Canadian Development Expense (CDE) to the partnership in an amount equal to the subscription price of the Resource Co's common shares; that CEE and CDE is then flowed through the partnership to the limited partner investors;
9. traditional Flow-Through Offerings commonly provide that the general partner may propose a liquidity mechanism to the limited partners 18 to approximately 24 months after closing of an initial public offering; such liquidity mechanisms typically involve terminating the partnership after exchanging partnership assets for securities of a mutual fund corporation or other investment vehicle on a tax-deferred basis; under some Traditional Flow-Through Offerings, such liquidity mechanism is subject to approval by the limited partners at a special meeting; under other Traditional Flow-Through Offerings, no such approval is required;
10. if a liquidity mechanism is not implemented, the limited partners in a Traditional Flow-Through Offering receive a *pro rata* share of the net assets of the partnership, including the common shares of Resource Cos held by the partnership, on the dissolution of the partnership;
11. in the flow-through offering structure proposed by the Filer (the Proposed Flow-Through Offering), an additional investment in a single-purpose financing vehicle will be added to the Traditional Flow-Through Offering structure;
12. investors who have passed a credit evaluation will have the opportunity to first make an RRSP or RRIF-eligible investment in bonds issued by a single-purpose financing entity, Qwest Energy 2005 Financial Corp. (Financial Corp.), a wholly-owned subsidiary of a TSX Venture Exchange listed company, Knightswood Financial Corp.;
13. accordingly, an investor, his or her registered retirement savings plan (RRSP), his or her registered retirement income fund (RRIF) or the RRSP or RRIF of the investor's spouse or child, or a private corporation existing under the Canada Business Corporations Act or the laws of any of the Jurisdictions, as applicable, will purchase bonds of Financial Corp. maturing on December 31, 2014 which bear cumulative interest at a rate of 5.0% per annum (the Bonds);

2005 BCSECCOM 131

the Bonds will be sold by way of an initial public offering using an prospectus in each of the Jurisdictions;

14. Financial Corp. will then loan (a Loan) the net proceeds from each investor's or RRSP's or RRIF's or corporation's purchase of Bonds to that investor (an RRSP Investor); each Loan will bear interest at a fixed cumulative interest rate of 7.85% per annum and repayment of principal will be due on December 31, 2014; each Loan will be secured by a pledge of Units of the Filer acquired by the RRSP Investor (with proceeds from the Loan) and any Warrants, Flow-Through Shares or Mutual Fund Shares (as defined below) registered in the name of the RRSP Investor along with the RRSP Investor's interest in the Investment Portfolio (as defined below) at any time before or after the Filer's dissolution;
15. RRSP Investors will be required by the terms of the Loan to purchase non-transferable Units of the Filer;
16. the Units will be sold by way of an initial public offering in each of the Jurisdictions using a prospectus; in addition to being sold to RRSP Investors, Units will also be sold to conventional purchasers of Flow-Through Shares, other than RRSP Investors, although these purchasers will not receive the same overall tax benefit as an RRSP Investor whose beneficially-owned RRSP or RRIF or whose spouse's or child's beneficially-owned RRSP or RRIF, as applicable, has invested in Bonds; the gross proceeds of the offering of Units (the Funds) will be deposited in a bank account of the General Partner;
17. the limited partnership agreement (the Partnership Agreement) governing the Filer:
 - (a) includes standard provisions governing: the formation of the Filer; partnership capital; sales of Units; allocation of income gain and loss; distributions; liabilities of partners; function and powers of the limited partners and the general partner; accounting and reporting; and partnership meetings;
 - (b) sets out the investment objectives, strategy and guidelines pursuant to which the Partnership's investment activities will be conducted;
 - (c) requires the Filer to be dissolved, without any approval or other action by the Limited Partners on December 31, 2005, or such earlier date on which the Filer disposes of all of its assets, or a date authorized by an extraordinary resolution of the Limited Partners;

2005 BCSECCOM 131

- (d) provides that as soon as practicable following the Filer's acquisition of, any Warrants (as defined below) to purchase flow-through shares of Resource Cos, and in any event not later than upon the dissolution of the Filer, such Warrants will be distributed among the Limited Partners of the Filer pro rata along with Funds sufficient to permit the exercise of such Warrants;
 - (e) grants to the General Partner an irrevocable power of attorney, which will survive the dissolution of the Filer, to exercise Warrants to purchase flow-through shares of Resource Cos on behalf of the Limited Partners of the Filer and enter into Investment Agreements (as defined below) with Resource Cos; and
 - (f) grants the General Partner the authority, which will survive the dissolution of the Filer, as agent for each Limited Partner, to direct payment of the Funds to Resource Cos upon exercise of Warrants to purchase flow through shares of Resource Cos by the Limited Partners;
18. certificates representing the Units will be issued under the book-based system and registered in the name of CDS & Co.; Financial Corp. will hold a security interest in Units beneficially owned by RRSP Investors pursuant to the terms of a pledge contained in the Loan documentation;
19. from time to time throughout 2005, the Filer, as principal, will enter into agreements to subscribe for warrants, rights or options (the Warrants) issued by Resource Cos to purchase their flow-through shares (and possibly other incidental securities, such as share purchase warrants that are comprised in a unit with a flow-through share) (collectively, the Flow-Through Shares) from treasury; the Filer will pay nominal consideration to Resource Cos for these Warrants;
20. the Filer anticipates that it will acquire the Warrants under the registration and prospectus exemptions contained in the Legislation applicable to purchases of securities made by "accredited investors" in Ontario and under Multilateral Instrument 45-103 *Capital Raising Exemptions* in other jurisdictions, as a non-redeemable investment fund that distributes its securities under a prospectus;
21. the Warrants will:
- (a) set the exercise price to purchase the Flow-Through Shares, based on negotiation between the General Partner and the Resource Cos;
 - (b) be exercisable for a brief period of time (not to exceed 45 days);

2005 BCSECCOM 131

- (c) be transferable to the Limited Partners of the Filer at any time during their term;
 - (d) be distributable to the Limited Partners of the Filer as soon as practicable and in no event later than upon the dissolution of the Filer;
 - (e) in the case of Warrants distributed to RRSP Investors, be pledged to Financial Corp. as security for Loans;
 - (f) require the execution of an Investment Agreement (defined below) by the Resource Cos and the General Partner, as attorney for each of the Limited Partners, at the time of exercise of the Warrants and before the issuance of the Flow-Through Shares to the Limited Partners;
22. the Investment Agreement and the Warrants will require that the Resource Cos use 70% or more of the proceeds received by them on the purchase of the Flow-Through Shares following the exercise of the Warrants to incur CEE or qualifying CDE, which will be renounced to the holders of the Flow-Through Shares effective on December 31, 2005; the balance of such proceeds will be required to be used to incur non-qualifying CDE, which will be renounced to the holders of the Flow-Through Shares effective no later than December 31, 2006;
23. the Loan documentation between Financial Corp. and each RRSP Investor will require each RRSP Investor's Warrants (and any Flow-Through Shares received on exercise thereof and interest in the Investment Portfolio (as defined below)) to be pledged as security for his or her Loan; the share certificates representing the Flow-Through Shares, together with the cash from, or other securities obtained with any proceeds from, the sale of the Flow-Through Shares or such other securities (the Investment Portfolio) will be held by an escrow agent (the Escrow Agent), which will be a Trust Company, for the benefit of the Limited Partners; the escrow agreement governing the conduct of the Escrow Agent will provide that if an RRSP Investor defaults on his or her Loan and fails to rectify the default within 15 days of receiving notice of such default, the Escrow Agent will release such RRSP Investor's interest in the Investment Portfolio to Financial Corp. to allow for execution against such pledged security;
24. throughout 2005, the Resource Cos who grant Warrants to the Filer will require funding; accordingly, it will become appropriate for the Warrants to be exercised and Flow-Through Shares purchased with some of the Funds; the Filer will distribute from the Funds the exercise price of the Warrants to the

2005 BCSECCOM 131

Limited Partners *pro rata*; such Funds will be held by the General Partner as agent on behalf of the Limited Partners;

25. the General Partner, acting on behalf of the Limited Partners, will notify the Resource Cos that the Limited Partners have elected to exercise their Warrants to purchase Flow-Through Shares and, as attorney on behalf of each Limited Partner, will enter into subscription agreements (the Investment Agreements) with Resource Cos, under which each Limited Partner, in his or her personal capacity and not in his or her capacity as Limited Partner, will exercise and subscribe for Flow-Through Shares issued by the Resource Cos under the terms of each Limited Partner's Warrants; the Investment Agreements will contain the same terms as are included in conventional flow-through share subscription agreements, including the requirement for the Resource Cos to use 70% or more of the proceeds received by them from the purchase of the Flow-Through Shares to incur CEE or qualifying CDE which will be renounced to the holders of the Flow-Through Shares effective on December 31, 2005; the balance of such proceeds will be required to be used to incur non-qualifying CDE, which will be renounced to the holders of the Flow-Through Shares effective no later than December 31, 2006;
26. concurrently with the execution of the Investment Agreements, the General Partner, as agent for each Limited Partner, will direct payment to the Resource Cos of the exercise price for the Flow-Through Shares from the Funds; certificates representing Flow-Through Shares will be issued and registered in the name of the Escrow Agent for the benefit of the Limited Partners;
27. some of the Flow-Through Shares will be qualified by a prospectus and, therefore will be freely tradeable; however, some of the Flow-Through Shares (the Restricted Flow-Through Shares) may be issued on a private placement basis and accordingly subject to hold periods;
28. on or immediately prior to December 31, 2005, the Filer will be dissolved; it is anticipated that all Warrants will have been transferred to the Limited Partners and exercised and the vast majority of the Funds will have been expended to purchase Flow-Through Shares before the dissolution of the Filer;
29. immediately before the dissolution, any remaining Funds will be distributed by the Filer to the Limited Partners *pro rata* in proportion to the number of Units held by each Limited Partner;
30. the Investment Portfolio will be held by the Escrow Agent and will be managed on an ongoing basis by a registered portfolio manager;

2005 BCSECCOM 131

31. the former Limited Partners will grant contractual discretion to sell Flow-Through Shares (respecting any seasoning periods attached thereto) and other securities comprising the former Limited Partner's Investment Portfolio and to reinvest the net proceeds from such dispositions in securities of resource issuers whose principal business is oil and gas, mining, certain energy production, pulp and paper, forestry, or a related resource business, such as a pipeline or service company or utility on the directions of a registered portfolio manager;
32. between February 28, 2007 and June 30, 2007, the General Partner may implement a transaction to provide for liquidity and long-term growth of capital, which may involve exchanging each former Limited Partner's Investment Portfolio for redeemable securities (Mutual Fund Shares) of a mutual fund corporation or other investment vehicle (the Mutual Fund) on a tax-deferred basis (a Liquidity Transaction); any such liquidity rollover will be subject to obtaining all necessary regulatory approvals and must occur on or before June 30, 2007; the General Partner may, in its sole discretion, call a meeting of the former Limited Partners to approve a Liquidity Transaction and no Liquidity Transaction proposed for approval will be implemented if such former Limited Partners holding a majority of the interests in the Investment Portfolio represented at such meeting vote against a proceeding with the Liquidity Transaction;
33. each RRSP Investor's interest in the Investment Portfolio will be held by the Escrow Agent for the benefit of such RRSP Investor under the escrow agreement until the earlier of a Liquidity Transaction and December 31, 2007; if a Liquidity Transaction closes on or prior to June 30, 2007, the Escrow Agent will release and deliver each RRSP Investor's interest in the Investment Portfolio to the Mutual Fund and the Mutual Fund Shares will be delivered by the Mutual Fund to Financial Corp. and held by Financial Corp. as security for that RRSP Investor's Loan under the terms of a pledge contained in the Loan documentation; if a Liquidity Transaction does not occur on or prior to June 30, 2007, on December 31, 2007 each RRSP Investor's interest in the Investment Portfolio will be released to Financial Corp. and held by Financial Corp. as security for that RRSP Investor's Loan under the terms of a pledge contained in the Loan documentation;
34. each non-RRSP Investor's interest in the Investment Portfolio will be held by the Escrow Agent for the benefit of such non-RRSP Investors under the escrow agreement, until the earlier of a Liquidity Transaction and December 31, 2007; if a Liquidity Transaction is closed on or prior to June 30, 2007, each non-RRSP Investor's interest in the Investment Portfolio will be released and delivered by the Escrow Agent to the Mutual Fund in exchange for

2005 BCSECCOM 131

Mutual Fund Shares which will delivered to each non-RRSP Investor; if a Liquidity Transaction is not closed on or prior to June 30, 2007, on December 31, 2007 each non-RRSP Investor's interest in the Investment Portfolio will be released by the Escrow Agent to such non-RRSP Investor;

35. on December 31, 2014, the Loans will become due; the Loans, however, may also be repaid in full on the last day of each month beginning on the earlier of June 30, 2007 and the last business day of the month in which a Liquidity alternative closes and ending on November 30, 2014 upon written notice given no later than the 15th day of such month and no earlier than 60 days prior to the last day of such month; upon repayment in full of each Loan, the RRSP Investors' interest in the Investment Portfolio or Mutual Fund Shares held by or on behalf of Financial Corp. as security for the Loan will be released to the appropriate RRSP Investor; if a Liquidity Transaction is not closed on or prior to June 30, 2007, the earliest date that such release will occur will be December 31, 2007;
36. the principal received by Financial Corp. from repayment of the Loans will be distributed to owners of Bonds as a repayment of principal and it is anticipated that Financial Corp. will wind-up within the six months after repayment of the Bonds;
37. for tax purposes, in order to allow the full amount of the renounced CEE and qualifying CDE to be available to the RRSP Investors, the Limited Partners must be the persons who exercise the Warrants and acquire the Flow-Through Shares, rather than the Filer itself, accordingly, for tax purposes, the Warrants must be transferred to the RRSP Investors before they are exercised;
38. the Filer cannot rely on the registration and prospectus exemptions in the Legislation relating to the distribution of securities as part of a winding-up to distribute all of the Warrants to the Limited Partners because the formal winding-up of the Filer is not scheduled to occur until the end of December of 2005; the Filer could structure the Proposed Flow-Through Offering to include multiple limited partnerships that could be wound-up whenever Warrants had to be distributed; however, this would increase administrative time, expense and complexity and the likelihood of investor confusion;
39. due to the structure of the Proposed Flow-Through Offering, the Flow-Through Shares will be subject to contractual restrictions on transfer by the Limited Partners under an escrow agreement until at least June 30, 2007, restrictions that are similar to those that would typically occur in Traditional Flow-Through Offerings.

2005 BCSECCOM 131

Decision

- ¶ 4 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.

The decision of the Decision Makers under the Legislation is that the Registration and Prospectus Requirements do not apply to the Non-Exempt Trades, provided that the first trade in a Warrant (other than a Non-Exempt Trade) or a Restricted Flow-Through Share issued upon exercise of a Warrant is deemed to be a distribution or a primary distribution to the public unless the conditions in sections 2.5(2) and (3) of MI 45-102 *Resale of Securities* are satisfied.

Martin Eady, CA
Director, Corporate Finance
British Columbia Securities Commission