

2003 BCSECCOM 632

Headnote

Mutual Reliance Review System for Exemptive Relief Applications – relief from registration and prospectus requirements for trades of warrants to a limited partnership and first trades of those warrants by the limited partnership to its limited partners – first trade of securities acquired deemed a distribution unless certain conditions in Multilateral Instrument 45-102 are satisfied – previous decision revoked and replaced

Applicable British Columbia Provisions

Securities Act, R.S.B.C. 1996, c. 418, ss. 34(1)(a), 48, 61, 76 and 171

IN THE MATTER OF THE SECURITIES LEGISLATION OF BRITISH COLUMBIA, ALBERTA, SASKATCHEWAN, MANITOBA AND ONTARIO

AND

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

AND

IN THE MATTER OF QWEST ENERGY RSP/FLOW-THROUGH LIMITED PARTNERSHIP

MRRS DECISION DOCUMENT

- ¶ 1 WHEREAS the local securities regulatory authority or regulator (the “Decision Maker”) in each of British Columbia, Alberta, Saskatchewan, Manitoba and Ontario (the “Jurisdictions”) has received an application from Qwest Energy RSP/Flow-Through Limited Partnership (“Qwest”) 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, in British Columbia, Alberta, Saskatchewan and Manitoba, to the acquisition of Warrants (defined below) by Qwest (the “Warrant Acquisitions”) or, in each of the Jurisdictions, to the first trade of Warrants by Qwest to the limited partners (the “Limited Partners”) of Qwest (the “Non-Exempt Trades”);

2003 BCSECCOM 632

- ¶ 2 AND WHEREAS Qwest previously received relief from the Registration and Prospectus Requirements for the Warrant Acquisitions and the first trade of Warrants in a decision document dated June 20, 2003 (the “Previous Decision”), granted by the Decision Makers in British Columbia, Alberta, Manitoba and Ontario under the Mutual Reliance Review System for Exemptive Relief Applications (the “System”);
- ¶ 3 AND WHEREAS Qwest has also applied for a decision under the Legislation revoking the Previous Decision;
- ¶ 4 AND WHEREAS under the System, the British Columbia Securities Commission is the principal regulator for this application;
- ¶ 5 AND WHEREAS, unless otherwise defined, the terms herein have the meaning set out in National Instrument 14-101 *Definitions*;
- ¶ 6 AND WHEREAS Qwest has represented to the Decision Makers that:
1. Qwest is a limited partnership formed under the laws of British Columbia on December 30, 2002 under the *Partnership Act* (British Columbia) to achieve capital appreciation for its Limited Partners primarily by investing in a diversified portfolio of options, warrants or similar rights to purchase flow-through shares issued by resource issuers whose principal business is oil and gas/mineral exploration, development and/or production or energy generation;
 2. Qwest’s head office is located in British Columbia;
 3. Qwest is authorized to issue an unlimited number of limited partnership units (the “Units”), of which one Unit is currently issued and outstanding;
 4. Qwest is not currently a reporting issuer or the equivalent in any jurisdiction in Canada;
 5. Qwest Energy RSP/Flow-Through Management Corp. (the “General Partner”) is the general partner of Qwest and manages the business and affairs of Qwest;
 6. Qwest wishes to conduct a financing in the Jurisdictions by way of private placement using an offering memorandum;
 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 listed on a Canadian stock exchange and whose principal business is oil and gas/mineral

2003 BCSECCOM 632

exploration, development and/or production or energy generation; such Traditional Flow-Through Offerings are usually blind pool offerings;

8. following the first closing of a Traditional Flow-Through Offering, the limited partnership will enter into agreements to subscribe for common shares from the treasury of one or more 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 will propose a liquidity mechanism to the limited partners, at a special meeting to be held 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;
10. if the limited partners do not pass an extraordinary resolution to exchange the partnership’s assets for the securities of a mutual fund corporation or other investment vehicle on a tax-deferred basis, the limited partners receive a *pro rata* share of the net assets of the partnership, including the common shares of Resource Cos held by the partnership;
11. in the flow-through offering structure proposed by Qwest (the “Proposed Flow-Through Offering”), an additional investment in a single-purpose financing vehicle will be added to the Traditional Flow-Through Offering structure, and the limited partnership will be dissolved sooner than is the case with Traditional Flow-Through Offerings;
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 RSP/Flow-Through 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, as applicable, will purchase bonds of Financial Corp. maturing on December 31, 2012 which bear cumulative

2003 BCSECCOM 632

interest at a rate of approximately 5% per annum (the “Bonds”); the Bonds will initially be sold by way of private placement using an offering memorandum 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 purchase of Bonds to that investor (an “RRSP Investor”); each Loan will bear interest at a fixed cumulative interest rate of approximately 7.5% per annum and repayment of principal will be due on December 31, 2012; each Loan will be secured by a pledge of Units of Qwest 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 Qwest’s dissolution;
15. RRSP Investors will be required by the terms of the Loan to purchase Units of Qwest;
16. the Units will be sold by way of private placement using an offering memorandum; 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 who has invested in Bonds or 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 net 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 Qwest will:
 - (a) include standard provisions governing the formation of Qwest; capital; investment objectives, strategy and guidelines; liabilities of partners; and function and powers of the partners;
 - (b) require Qwest to be dissolved, without any approval or other action by the Limited Partners on December 31, 2003, or such earlier date on which Qwest disposes of all of its assets, or a date authorized by an extraordinary resolution of the Limited Partners;
 - (c) provide that on dissolution of Qwest, any Warrants (as defined below) to purchase flow-through shares of Resource Cos registered in the name of

2003 BCSECCOM 632

Qwest will be distributed among the former Limited Partners of Qwest *pro rata*;

- (d) grant to the General Partner an irrevocable power of attorney, which will survive the dissolution of Qwest, to exercise Warrants to purchase flow-through shares of Resource Cos on behalf of the former holders of Units and enter into Investment Agreements (as defined below) with Resource Cos; and
 - (e) grant the General Partner the authority, which will survive the dissolution of Qwest, 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 issued and registered in the name of an RRSP Investor will be delivered to and held by or on behalf of Financial Corp. as security for that RRSP Investor's Loan under the terms of a pledge contained in the Loan documentation;
19. from time to time throughout 2003, Qwest, as principal, will then 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; Qwest will pay nominal consideration to each Resource Co in consideration for the issuance of these Warrants;
20. Qwest anticipates that the Warrants will be issued under the registration and prospectus exemptions contained in the Legislation applicable to purchases of securities made by "accredited investors" in Ontario;
21. as a "non-redeemable investment fund", Qwest cannot rely on the accredited investor exemption in Multilateral Instrument 45-103 *Capital Raising Exemptions* in British Columbia, Alberta, Saskatchewan or Manitoba to acquire the Warrants;
22. 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 30 days);

2003 BCSECCOM 632

- (c) be transferable to the Limited Partners of Qwest at any time during their term;
 - (d) be distributable on the dissolution of Qwest among the former Limited Partners of Qwest;
 - (e) in the case of Warrants distributed to RRSP Investors, be pledged to Financial Corp. as security for Loans and documentation evidencing these Warrants will be held by Financial Corp.;
 - (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;
23. the Investment Agreement and the Warrants will require that the Resource Cos use not less than 70% 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, and to use the remainder of the proceeds to incur non-qualifying CDE, which will be renounced to the holders of the Flow-Through Shares effective on December 31, 2003;
24. 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 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)) to be pledged as security for his or her Loan; the documents evidencing the Warrants will be held by Financial Corp. as security for each RRSP Investor's Loan; the share certificates representing the Flow-Through Shares or any other interest in the Investment Portfolio (as defined below) 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 Flow-Through Shares and other interest in the Investment Portfolio to Financial Corp. to allow for execution against such pledged security;
25. throughout 2003, the Resource Cos who grant Warrants to Qwest will require funding; accordingly, it will become appropriate for the Warrants to be exercised and Flow-Through Shares purchased with some of the Funds; Qwest will distribute from the Funds the exercise price of the Warrants to the Limited

2003 BCSECCOM 632

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

26. 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 not less than 70% of the proceeds received by them from the purchase of the Flow-Through Shares to incur CEE or qualifying CDE and to use the remainder of the proceeds to incur non-qualifying CDE, which will be renounced to the holders of the Flow-Through Shares effective on December 31, 2003;
27. 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 names of the Limited Partners (or in the name of the Escrow Agent for the benefit of the Limited Partners) and the General Partner will pay to each Resource Co the exercise price for these Flow-Through Shares from the Funds on behalf of the Limited Partners;
28. the Flow-Through Shares issued and registered in the name of each RRSP Investor (or in the name of the Escrow Agent for the benefit of each RRSP Investor) will be held by the Escrow Agent under an escrow agreement until the earlier of a Liquidity Transaction (as defined below) and December 31, 2005; thereafter, any Flow-Through Shares, any portion of the Investment Portfolio or any Mutual Fund Shares registered in the name of each RRSP Investor (or in the name of the Escrow Agent for the benefit of each RRSP Investor) will be released by the Escrow Agent 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;
29. Flow-Through Shares issued and registered in the names of Limited Partners other than RRSP Investors will be delivered to and physically held by the Escrow Agent for the benefit of each such Limited Partner, under an escrow agreement, until the earlier of a Liquidity Transaction (as defined below) and

2003 BCSECCOM 632

December 31, 2005; thereafter, certificates and funds in the non-RRSP Investor's Investment Portfolio will be released by the Escrow Agent to the non-RRSP Investors;

30. 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;
31. shortly before December 31, 2003, Qwest 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 Qwest;
32. immediately before the dissolution, any remaining Funds will be distributed by Qwest to the Limited Partners *pro rata* in proportion to the number of Units held by each Limited Partner;
33. the portfolio of Flow-Through Shares issued and registered in the name of each former Limited Partner (or in the name of the Escrow Agent for the benefit of such former Limited Partner) and any other securities or cash obtained with any proceeds from the sale of such Flow-Through Shares or such other securities (the "Investment Portfolio") will be held by the Escrow Agent and will be managed on an ongoing basis by a registered portfolio manager;
34. the Escrow Agent will be granted the contractual discretion by the former Limited Partners 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;
35. on or about February 28, 2005, the General Partner may make a proposal to former Limited Partners to provide for liquidity and long-term growth of capital, which may involve exchanging each former Limited Partner's Investment Portfolio for shares ("Mutual Fund Shares") of a mutual fund corporation or other investment vehicle 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, 2005;

2003 BCSECCOM 632

each former Limited Partner may elect whether or not to exchange their Investment Portfolio for such Mutual Fund Shares;

36. on December 31, 2012, the Loans will become due; the Loans, however, may also be repaid in full on the last day of each month beginning on June 30, 2005 and ending on November 30, 2012 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 certificates and Funds in the RRSP Investors' 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; for RRSP Investors who have repaid the Loan in full but who did not elect to participate in a Liquidity Transaction, the earliest date that the release will occur will be December 31, 2005;
37. 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;
38. 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 Qwest itself; accordingly, for tax purposes, the Warrants must be transferred to the RRSP Investors before they are exercised;
39. Qwest 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 Qwest is not scheduled to occur until the end of December of 2003; Qwest 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;
40. 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 until at least June 30, 2005, restrictions that are similar to those that would typically occur in Traditional Flow-Through Offerings;

¶ 7 AND WHEREAS under the System, this MRRS Decision Document evidences the decision of each Decision Maker (collectively, the "Decision");

2003 BCSECCOM 632

¶ 8 AND WHEREAS 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;

¶ 9 THE DECISION of the Decision Makers under the Legislation is that the Registration and Prospectus Requirements do not apply:

- (a) in British Columbia, Alberta, Saskatchewan and Manitoba, to the Warrant Acquisitions, and
- (b) 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 unless the conditions in sections 2.5(2) and (3) of MI 45-102 *Resale of Securities* are satisfied.

¶ 10 THE FURTHER DECISION of the Decision Makers in British Columbia, Alberta, Manitoba and Ontario is that the Previous Decision is revoked.

¶ 11 September 15, 2003

Derek E. Patterson
Acting Director