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## Headnote

Mutual Reliance Review System for Exemptive Relief Applications – relief from the registration and prospectus requirements for trades in preferred shares to franchisees - franchisor paying special rebates to franchisees that must be applied toward purchase of preferred shares - shares are redeemable at issue price in certain circumstances

## Applicable British Columbia Provisions

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

IN THE MATTER OF THE SECURITIES LEGISLATION OF THE PROVINCES OF BRITISH COLUMBIA, ALBERTA, SASKATCHEWAN, MANITOBA, NEW BRUNSWICK, NOVA SCOTIA, PRINCE EDWARD ISLAND, AND NEWFOUNDLAND AND LABRADOR

AND

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

AND

IN THE MATTER OF CARPET ONE CANADA INC.

## MRRS DECISION DOCUMENT

WHEREAS the local securities regulatory authority or regulator (the "Decision Maker") in each of British Columbia, Alberta, Saskatchewan, Manitoba, New Brunswick, Nova Scotia, Prince Edward Island, and Newfoundland and Labrador (the "Jurisdictions") has received an application from Carpet One Canada Inc. (the "Corporation") for a decision under the securities legislation of the Jurisdictions (the "Legislation") that the requirements under the Legislation to be registered to trade in a security and to file and obtain a receipt for a preliminary prospectus and a prospectus (the "Registration and Prospectus Requirements") shall not apply to certain trades in Preferred Shares (as defined below) of the Corporation;

AND WHEREAS under the Mutual Reliance Review System for Exemptive Relief Applications (the "System") the British Columbia Securities Commission is the principal regulator for this application;

AND WHEREAS the Corporation has represented to the Decision Makers that:

1. the Corporation was incorporated in Ontario on November 28, 1995;
2. the Corporation's authorized capital is an unlimited number of Class A shares, Class B shares, Class C shares and common shares (collectively, the "Existing Shares"), of which there is currently 1 common share issued and outstanding, the holder of which is Carpet Co-Op of America Association ("CCOAA");
3. the Existing Shares are all subject to restrictions on transfer contained in the articles of the Corporation;
4. the Corporation is not a reporting issuer in any jurisdiction, and has no intention of becoming a reporting issuer in any jurisdiction;

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5. none of the Existing Shares of the Corporation are listed or posted for trading on any stock exchange; the Preferred Shares (as defined below) will not be listed or posted for trading on any stock exchange;

6. the Corporation carries on the business of operating a franchise arrangement of carpet dealers (the "Franchisees") across Canada; each Franchisee has entered into a franchise agreement (the "Franchise Agreement") with the Corporation which governs the terms and conditions in respect of the operation of such Franchisee's Carpet One Canada franchise operation; there are currently 92 Franchisees;

7. under the Franchise Agreement, the Corporation, as franchiser, has agreed to pay each of the Franchisees an amount of monies (a "Regular Rebate") equal to all advertising rebates, manufacturing rebates and any other monies generated by the Franchisee as a result of such Franchisee's purchasing of all types of floor coverings, calculated on the basis set out in the Franchise Agreement;

8. in addition to the Regular Rebates, the Corporation proposes to pay a special rebate (the "Special Rebate") to the Franchisees in an amount declared by the Corporation from time to time; each Franchisee will be entitled to receive its proportionate share of the Special Rebate which will be a fraction with the numerator being the amount of the Regular Rebates paid to the Franchisee and the denominator being the total amount of Regular Rebates paid to all eligible Franchisees, in the applicable fiscal year;

9. prior to the Corporation declaring a Special Rebate, each Franchisee eligible to receive a portion of the Special Rebate must provide a written direction (the "Direction") to the Corporation agreeing to have its portion of the Special Rebate applied to the purchase of a new class of preference shares of the Corporation (the "Preferred Shares") at a price of \$1.00 per Preferred Share;

10. the Preferred Shares will not pay dividends and will not entitle the holders thereof to vote (other than as may be required by law);

11. the Preferred Shares:

(a) may be redeemed by the Corporation for \$1.00 per Preferred Share at any time at the Corporation's option, and

(b) will be redeemed and will be deemed to be redeemed by the Corporation automatically upon termination of a Franchisee's Franchise Agreement for \$1.00 per Preferred Share payable in five equal annual instalments, with the first instalment payable on the date which is the later of:

(i) three years following the date the Preferred Shares were first issued to the Franchisee, and

(ii) the first anniversary of the date the Franchise Agreement with the Franchisee is terminated;

12. the Corporation will amend its articles:

(a) to create the class of Preferred Shares,

(b) to include restrictions on the transfer of Preferred Shares which reflect those contained in each Franchise Agreement, and

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(c) to delete certain of its private company restrictions which limit its shareholders to not more than 50 (but not the restrictions on the transfer of the Existing Shares), as it is proposed that the Corporation will have more than 50 shareholders;

13. after the Corporation amends its articles, it will not be a "private issuer" (or the equivalent) under the Legislation;

14. the Franchisees and Corporation will amend the Franchise Agreements to provide a restriction on the transfer of the Preferred Shares, including a provision that the Franchisee may not make a gift of any Preferred Shares owned by it and may not sell, transfer, hypothecate or otherwise dispose of any of its Preferred Shares without the prior written consent of the Corporation, which consent may be arbitrarily withheld;

15. the certificates representing the Preferred Shares will bear a legend stating that the Preferred Shares are subject to restrictions on transfer in the Franchise Agreement and the Corporation's articles of incorporation;

16. the issuance of the Preferred Shares will be made only to Franchisees who have executed the Direction and a subscription agreement pursuant to which the Franchisee agrees to abide by and be bound by the Corporation's articles of incorporation, as amended, its by-laws and its policies.

17. CCOAA holds shareholder meetings annually, at which time all shareholders of CCOAA (which includes the Franchisees) are provided with a review of the operating results of both CCOAA and the Corporation, and are provided with the opportunity to ask questions of management of CCOAA and the Corporation;

18. the Corporation will deliver to its shareholders (including the holders of Preferred Shares) on a continuous basis, consolidated annual audited comparative financial statements of CCOAA, as if the Corporation were subject to the provisions of the Legislation in respect of the preparation and delivery of audited annual financial statements contained in the Legislation; and

19. the annual financial statements of CCOAA will include, as note disclosure, a statement as to the number of Preferred Shares outstanding and confirmation as to whether the Corporation has sufficient funds available to pay the redemption price for all of the outstanding Preferred Shares;

AND WHEREAS pursuant to the System this MRRS Decision Document evidences the decision of each Decision Maker (the "Decision");

AND WHEREAS each of the Decision Makers is satisfied that the test contained in the Legislation that provided the Decision Maker with the jurisdiction to make the Decision has been met;

THE DECISION of the Decision Makers under the Legislation is that:

(a) the Registration and Prospectus Requirements shall not apply to the proposed distribution of Preferred Shares by the Corporation to Franchisees from time to time, provided that:

(i) prior to the initial trade of Preferred Shares to each Franchisee, the Corporation delivers to the Franchisee a copy of:

(A) the articles and by-laws of the Corporation, and all amendments thereto;

(B) the most recent annual audited consolidated financial statements of CCOAA;

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(C) this MRRS Decision Document; and

(D) a statement to the effect that as a consequence of this MRRS Decision Document, certain protections, rights and remedies provided by the Legislation, including statutory rights of rescission or damages, will not be available to purchasers of Preferred Shares and that certain restrictions are imposed on the subsequent disposition of the Preferred Shares; and

(ii) the first trade in Preferred Shares shall be deemed a distribution; and

(b) the Registration and Prospectus Requirements shall not apply to first trades of Preferred Shares by a Franchisee to another Franchisee or to the Corporation in accordance with the Franchise Agreements.

DATED March 6, 2002.

Brenda Leong  
Director