

# The Secondary Trade<sup>1</sup>

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## Introduction

This paper builds on the paper “New Generation Co-operatives: Key Steps Relating to the Issuance of Securities” (the Primary Trade Paper), which describes the process for a **primary trade** of securities of a New Generation Co-operative (NGC). A primary trade is a sale of securities of an NGC by the NGC from its treasury to investors.

A **secondary trade** is a sale of securities of the NGC by the holders of those securities (having acquired the securities from the NGC under a primary trade). This paper discusses if and how a holder of securities in an NGC, having purchased securities from an NGC, can resell them. An additional term of note is that, if there is a market for the securities of an NGC, organized (like an exchange such as the Canadian Ventures Exchange (CDNX) or not organized (like sales directly between individual holders of the securities of the NGC), those sales are referred to as being made in the **secondary market**.

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<sup>1</sup> This paper does not necessarily represent the views of the Saskatchewan Securities Commission, nor does it constitute a legal opinion. Readers are advised to seek professional legal advice before proceeding.

## Background

The first thing to note is that securities of an NGC are securities within the meaning of *The Securities Act, 1988* (hereinafter the *Securities Act*). But for the provisions of *The New Generation Co-operative Act* (hereinafter *New Gen Act*), a trade or sale of securities of an NGC, whether it be a primary trade or a secondary trade, would be subject to the *Securities Act*.

The *New Gen Act* contains a waiver or exemption provision that says the *Securities Act* does not apply to a primary trade of securities of an NGC (although the NGC can elect to move its offering of securities or primary trade back under the provisions of the *Securities Act* if it wishes, or the Co-operative Securities Board (CSB) can direct that such offering be subject to the *Securities Act* if the CSB feels that it would be in the public interest to do so). There is no similar waiver or exemption provision in the *New Gen Act* for a secondary trade of securities of an NGC by a holder of those securities. In short, the secondary trades of securities of an NGC by the holders of those securities are subject to the *Securities Act*. This is true whether the primary trade with respect to the securities was carried out under the *New Gen Act* or the *Securities Act*.

When considering the application of the *Securities Act* to a disposition of a security like a security of an NGC (whether a primary trade or secondary trade), there are always two questions to consider. The first question is, Is the disposition of the security a **trade** within the meaning of the *Securities Act*? This generally means, is the disposition a sale or other disposition for valuable consideration? If the disposition is a trade, the person or company selling the security, whether it be a primary trade or secondary trade, must:

- be registered under the *Securities Act* to do the trade;
- find a statutory registration waiver or exemption in the *Securities Act* from the requirement to be registered under the *Securities Act* to do the trade; or

- apply for and obtain from the Saskatchewan Securities Commission (SSC) a discretionary registration waiver or exemption from the requirement to be registered under the *Securities Act* to do the trade.

The second question to be considered if the disposition of the security is a trade under the *Securities Act* is, Is the trade a **distribution** within the meaning of the *Securities Act*? This generally means, is the disposition a sale or other disposition for valuable consideration—

- from the treasury of the issuer of the securities (in other words, a primary trade); or
- from the holdings of a control person, promoter, incorporator, organizer, or underwriter of the issuer of the security (most are terms defined in the *Securities Act*) or from the holdings of persons or companies who acquired their securities under a statutory prospectus waiver or exemption in the *Securities Act* (see discussion of statutory prospectus waivers or exemptions below), in other words certain types of secondary trades.

A distribution does not include a disposition of a security by a person or company that acquired the security in an offering where the person or company received a prospectus under the *Securities Act* when they acquired the security as long the person or company is not a control person, promoter, incorporator, organizer, or underwriter of the issuer of the security.

If the disposition is a distribution, the person or company selling the security, whether it be a primary trade or the type of secondary trade discussed above, must:

- prepare and provide the purchaser of the security with a prospectus approved under the *Securities Act* to do the trade;
- find a statutory prospectus waiver or exemption in the *Securities Act* from the requirement to prepare and provide the purchaser of the security with a prospectus approved under the *Securities Act* to do the trade; or
- apply for and obtain from the SSC a discretionary prospectus waiver or exemption from the requirement to prepare and provide the purchaser of the security with a prospectus approved under the *Securities Act* to do the trade.

An additional matter to be considered when working with the *Securities Act* is that the use of a statutory prospectus waiver or exemption in the *Act* to sell a security triggers **resale restrictions** with respect to that security under the *Act*. Resale restrictions are restrictions on the purchasers of the security's ability to resell the security. These resale restrictions (sometimes referred to as **hold periods**) are generally indefinite unless the purchaser can find a statutory prospectus waiver or exemption in the *Securities Act* to sell the security, or the issuer of the security is or becomes a **reporting issuer** within the meaning of the *Act* (usually by filing a prospectus under the *Securities Act*). Resale restrictions are also usually imposed by the SSC in any discretionary prospectus waiver or exemption granted by the SSC with respect to an offering of securities. Resale restrictions under the *Securities Act* are not triggered by trades of securities under the *New Gen Act*.

For more information on the workings of the *Securities Act*, the waivers or exemptions, and the resale restrictions discussed above, consult "How to Raise Capital Using Exemptions," prepared by the SSC. This paper is available online at [www.ssc.gov.sk.ca](http://www.ssc.gov.sk.ca) or by calling the SSC at (306) 787-5299.

The *New Generation Co-operative Act* works differently from the *Securities Act*. The *New Gen Act* does not contain registration or prospectus requirements similar to those discussed above under the *Securities Act*. Nor does it contain resale restrictions (although, as noted earlier, the resale of securities of an NGC—that is, a secondary trade of securities of an NGC—is subject to the *Securities Act*).

As noted in the Primary Trade Paper, the *New Gen Act* provides that, with respect to a primary trade of securities of an NGC, the *Securities Act* does not apply unless the NGC chooses that it should apply, or the CSB directs that it should apply. If the *Securities Act* does not apply (if it did apply, the requirements discussed above would be triggered), an NGC must file with the CSB the information the CSB requires with respect to the primary trade and receive the approval of the CSB to do the trade. This is unless the NGC can fit itself within one of the waivers or exemptions from

these requirements in the *New Gen Act* or the regulations to that statute or has obtained a discretionary waiver or exemption from these requirements from the CSB. If the approval of the CSB is required, the approval may contain such terms and conditions as the CSB feels are suitable, a common one being that the NGC prepare and provide to the purchaser of the security a prospectus similar to that which would be required under the *Securities Act*. To date, it has been rare for the CSB to grant a discretionary waiver or exemption from the requirements of the *New Gen Act*.

For more discussion of the workings of the *New Generation Co-operatives Act* with respect to a primary trade of securities of an NGC, consult the Primary Trade Paper.

## The Secondary Trade

As noted above and in the Primary Trade Paper, a holder of securities of an NGC could have obtained their securities by one of the following methods:

- *Method 1*—by way of a prospectus offering under the *Securities Act*;
- *Method 2*—by way of an offering approved by the CSB, which approval has to date often included the requirement to use a prospectus similar to that which would be required under the *Securities Act*;
- *Method 3*—by way of statutory registration and prospectus waivers or exemptions contained in the *Securities Act*;
- *Method 4*—by way of statutory waivers or exemptions contained in the *New Gen Act*;
- *Method 5*—by way of a discretionary waiver or exemption applied for and granted by the SSC; or
- *Method 6*—by way of a discretionary waiver or exemption applied for and granted by the CSB, which, to date, have been rarely granted.

Regardless of the method by which the securities were acquired, the *Securities Act* applies to the secondary trade of the securities, although how the *Act* applies varies somewhat depending on the method used to acquire the securities. In considering the application of the *Securities Act* to a disposition of securities of an NGC, consider the two questions discussed above.

## Registration (Is the Disposition a Trade?)

Assuming the disposition is a sale or other disposition for valuable consideration, as opposed to a gift, which is not trade, it is a trade under the *Securities Act* no matter which method was used to acquire the security. As a trade, unless you are registered to sell securities, can find a statutory registration waiver or exemption in the *Securities Act* to sell the security, or have obtained a discretionary waiver or exemption from the SSC to sell the security, you cannot sell the security. You must continue to hold it.

For a discussion of statutory and discretionary waivers or exemptions please consult “How to Raise Capital Using Exemptions,” prepared by the SSC. This paper is available online at [www.ssc.gov.sk.ca](http://www.ssc.gov.sk.ca) or by calling the SSC at (306) 787-5299.

A statutory registration waiver or exemption in the *Securities Act* that might be helpful in some circumstances would be the isolated trade statutory registration waiver or exemption (the corresponding isolated trade statutory prospectus waiver or exemption differs from the statutory registration waiver or exemption and will be less helpful in the context of a prospectus).

There is also a statutory registration waiver or exemption in the *Securities Act* that allows for trades through a registrant under the *Act*. This may not be useful in the initial stages of development of an NGC, but should an NGC grow to a size where a registered dealer under the *Securities Act* runs an over-the-counter market for the securities of the NGC, or the securities of the NGC are listed on an exchange like the CDNX, this may provide a method for a holder of the securities of the NGC to sell them. This is not discussed in the above paper, but the provision can be found in clause 39(1)(j) of the *Securities Act*. In such cases, the holders of the securities would be holding freely tradable securities.

## Prospectus (Is the Disposition a Distribution?)

Assuming the disposition is a trade, the next question is, Is the trade a distribution? If it is, then the sale of the securities of an NGC will be subject to resale restrictions under the *Securities Act*. Only the use of a statutory prospectus waiver or exemption in the *Act* to trade securities will trigger resale restriction under the *Act* on those securities in the hands of the purchaser of those securities. Whether the sale is a distribution depends on the method under which the securities were acquired. Should you find that your sale would not be a distribution under the *Securities Act*, you are holding **freely tradable securities** in the prospectus context, **although you still need to consider the registration requirements discussed above.**

*Method 1*—If you acquired the securities under this method, unless you are a control person, promoter, incorporator, organizer, or underwriter of the issuer of the security, the disposition will not be a distribution, and the securities you hold are freely tradable.

*Method 2*—If you acquired the securities under this method, unless you are a control person, promoter, incorporator, organizer, or underwriter of the issuer of the security, the disposition will not be a distribution, and the securities you hold are freely tradable.

*Method 3*—If you acquired the securities under this method the securities you hold are subject to the resale restrictions set out in the *Securities Act*. Consult “How to Raise Capital Using Exemptions,” available online at [www.ssc.gov.sk.ca](http://www.ssc.gov.sk.ca) or by calling the SSC at (306) 787-5299. You may be subject to additional requirements if you are a control person, promoter, incorporator, organizer, or underwriter of the issuer of the security.

*Method 4*—If you acquired the securities under this method, unless you are a control person, promoter, incorporator, organizer, or underwriter of the issuer

of the security, the disposition will not be a distribution, and the securities you hold are freely tradable.

*Method 5*—If you acquired the securities under this method, the securities you hold are subject to whatever resale restrictions the SSC imposed on you in the waiver or exemption it granted with respect to the trade of the securities to you. You may be subject to additional requirements if you are a control person, promoter, incorporator, organizer, or underwriter of the issuer of the security.

*Method 6*—If you acquired the securities under this method, the securities you hold are subject to whatever resale restrictions the CSB imposed on you in the waiver or exemption it granted with respect to the trade of the securities to you. You may be subject to additional requirements if you are a control person, promoter, incorporator, organizer, or underwriter of the issuer of the security.

Trades of securities of an NGC by a control person, promoter, incorporator, organizer, or underwriter of the NGC will always be a distribution under the *Securities Act*.

In addition to the application of the *Securities Act*, you should always consider:

- the *New Gen Act*, which may contain provisions that affect a sale of the securities of an NGC; and
- the articles and by-laws of the NGC, which may contain additional restrictions on the sale of the securities of an NGC.

### **The Market-Making Mechanism**

It may be that an NGC has grown to a size where it has a large number of freely tradable securities outstanding held by a large number of security holders, but there is no registered dealer under the *Securities Act* running an over-the-counter market for the securities of the NGC, and the securities of the NGC are not listed on an

exchange like the CDNX. In this situation, an NGC may consider running its own market-making mechanism to provide liquidity to its security holders.

The market-making mechanism is a means whereby an NGC can create a secondary market for its securities. It does not provide a way for holders of its securities to avoid the resale restrictions discussed above; it just provides them with a place to go to find someone to buy them.

An issuer usually conducts a market-making mechanism by:

- constructing and regularly maintaining a list of all persons who would like to buy or sell the securities of the issuer;
- ensuring that all persons have an equal opportunity to put their name on the list as a buyer or a seller;
- ensuring that the list is publicly available;
- ensuring that the same corporate and financial information about the issuer is equally available to all persons on the list so that everyone involved in the process is on a level playing field;
- ensuring that historical sale prices for its securities are equally available to all persons on the list, to ensure transparency in the process;
- providing no investment advice to those involved in the process;
- not soliciting any person's involvement in the process;
- only carrying out activities of a purely administrative nature in the process; and
- since the process is a service to its security holders, charging no fee for participation in the process.

Under the *Securities Act*, this activity by an issuer of securities requires the issuer to become registered under the *Act* to carry it out or obtain from the SSC a discretionary waiver or exemption of the registration requirement in the *Act*. A number of issuers have obtained such a waiver or exemption, and the SSC instituted General Ruling/Order 45-903 for Community Bond Corporations to carry out this activity. The SSC will shortly institute a General Ruling/Order to allow all issuers to carry out these activities.

Because the *New Generation Co-operatives Act* provides that the *Securities Act* does not apply to trades by an NGC of its own securities, these activities by an NGC, as long as it deals only with its own securities and does not provide any investment advice (which is a registerable activity under the *Securities Act* not exempted under the *New Gen Act*), are not subject to the *Securities Act*, and no registration or discretionary waiver or exemption from the registration requirement in the *Act* is needed from the SSC.

Although it may not be clear, it appears by the wording of the *New Gen Act* that the approval of the CSB or a discretionary waiver of exemption from the CSB would be necessary for an NGC to carry out these activities, unless the NGC chooses or the CSB directs that the trades be subject to the *Securities Act*. Once the SSC has its General Ruling/Order in place for these activities for all issuers (which will occur shortly), this may be a reasonable course of action. As far as the writer is aware, the CSB has not yet considered this issue.