

New Generation Co-operatives

**Key Steps in the Issuance of Securities
and
The Secondary Trade**

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The Secondary Trade

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New Generation Co-operatives

An Introduction

BRENDA STEFANSON

The New Generation Co-operative (NGC) concept is attracting attention as a means of increasing farm income and offsetting some of the negative impacts of recent changes in agriculture. Saskatchewan has new legislation that makes it possible to achieve all the benefits of the NGC model. The purpose of this introduction is to provide a brief summary of the characteristics of the New Generation Co-operative model.

The agricultural system is undergoing dramatic change. Changes in technology, institutional structures, regulations, the integration of value chains, and the globalization of agricultural markets are resulting in an integrated system in which the family farm is increasingly interwoven with the food distribution chain. Consumers today are increasingly demanding choice, quality, consistency, and value. Producers and the food industry are capable of providing what the consumer wants, but only if changes are made to the structure of agriculture. Advances in biotechnology and information technology make it possible to engineer food at every level, from farm gate to dinner plate. Biotechnology enables the isolation and incorporation of specific traits in plants and animals, effectively providing what the consumer wants. Information technology enables the industry to monitor consumer preferences and track products throughout the value chain, incorporating this information at all levels.

These technological changes also necessitate changes in marketing channels. The preservation of product identity is required to assure that the character-specific product reaches the consumer who is demanding it. Commodity markets (where products are gathered, mixed, and passed to processors who produce generic food goods) are not structured to accommodate the designer products of the modern food chain. More direct marketing channels, such as production contracts and vertical integration, are required to maintain the identity of genetically altered or organically grown agricultural products. Experts predict that the vertical integration of marketing channels will continue to escalate.

Another change that profoundly affects Saskatchewan farmers is the loss of the WGTA, or “Crow” subsidy. Farmers now shoulder the full cost of transporting their raw commodities to distant ports. Saskatchewan producers, half-way between Vancouver and Thunder Bay, have witnessed the result of this change. The net effect of all these changes is obvious to the farmers: lower returns for primary production. Farmers have done everything in their power to adjust to these changes. They have increased their acreage, diversified into special crops and livestock, and reduced costs wherever possible. New strategies, different organizational structures, and new attitudes are necessary if Saskatchewan agriculture is to survive.

Farmers can exploit their position within a vertically integrated agricultural system if they retain ownership of their products beyond the farm gate and invest in ventures that add value to those products. The New Generation Co-operative model offers farmers the opportunity to join together to move up the value chain and capture some of the profits. The success of this structure has been witnessed in Minnesota and North Dakota, where sugar beet (since 1974), bison, and durum (since 1990) producers have owned processing facilities and gained returns, in the form of dividends, from those ventures. Other examples of NGCs include facilities to process organic grains, soybeans, eggs, specialty cheeses, and edible beans.

The NGC structure is unique, particularly in its share structure, which is characterized by three classes of shares: membership, equity, and preferred. The membership share gives the holder the right to vote and to

purchase equity shares, which are attached to delivery rights. NGCs are organized to add value to an agricultural commodity such as bison or durum. Only producers of the commodity can hold membership shares, thereby ensuring that control of the venture remains in the hands of the producers. NGCs adhere to the basic principles of co-operation set out by the Rochdale Society of Equitable Pioneers in 1844: democratic control, and one member, one vote. Voting rights are tied to membership, independent of the level of investment. This ensures that no one member can exercise control over the group.

The equity share allocates delivery rights to the co-operative and raises the capital necessary for establishing the venture. Each equity share purchased gives the member the right and the obligation to deliver one unit of product (i.e., one bison or one bushel of durum) to the co-operative for processing. This is a two-way contract: the member is committed to deliver, and the co-operative is committed to take delivery. The contract sets out the standards for quality, and delivery is regulated to keep the plant running at capacity. In today's market, quality and consistency are extremely important. Therefore, the delivery contract sets out specific quality conditions. The co-operative can reject deliveries if the products do not meet these quality standards. Rarely is this necessary, however, because the members contract only a portion of their production to the co-op, and they select the highest quality product for delivery to their own processing plant. In the event that a member is unable or unwilling to make delivery, the co-operative will purchase the amount of the product covered by the contract and charge the cost towards the member's equity account. This strategy ensures that the co-op will have a consistent quality and quantity of product, and can focus on developing markets.

The purchase of delivery rights (equity shares) represents a significant investment on behalf of producer-members and a significant equity infusion for the co-operative. In 1990, for example, the North American Bison Cooperative sold 180 membership shares at a cost of US\$100 each. These 180 members purchased a minimum of ten equity shares at US\$250 each, a minimum investment of US\$2500. The sale of delivery rights is a mechanism for securing start-up capital. Member equity investment represents 35–50 percent of the start-up costs. The obvious benefit to the co-operative

of low debt is augmented by the benefit of member commitment. The loyalty of members is locked in through the contract and the investment; the member has made a large investment and will act to ensure the success of the venture. The equity shares are tradeable and transferable. The shares have value and can be sold to other producers with the approval of the board of directors. Shares can be passed on to the next generation along with other assets.

The preferred share allows the co-operative to invite investment from non-producers. Preferred shareholders cannot vote except in certain circumstances, as described in the legislation. The preferred share offers a limited, fixed rate of return. Communities and non-producers choose to purchase preferred shares because they want to support development in their communities and encourage job and wealth creation close to home.

NGCs are select- or closed-membership co-operatives. A feasibility study determines the most efficient plant size, which, in turn, determines the amount of product the plant can accept. Equity shares are issued to members based on the capacity of the plant. Once the allotment of shares is sold, the membership is closed. New members will be accepted and additional equity shares issued if the plant expands. Comprehensive feasibility studies and business plans are critical to the success of these ventures. NGCs often operate in niche markets, where it is important to understand the type, quality, and quantity of product demanded. A clear understanding of markets and consumers has enabled these ventures to serve markets that large corporations cannot.

Although some co-operatives have actually increased the price of the raw commodity, the primary economic benefit to members flows from the dividends of processing and marketing. Producers are paid market price for the delivery of their raw commodity, but because they own the processing plant, they gain returns from processing activities as well. They have vertically integrated upwards in the food industry and captured the returns to primary and secondary processing.

The vertically integrated structure encourages the effective use of market and production information. The structure enables market information to be combined with local production knowledge to produce the type of product required to serve lucrative niche markets.

The term New Generation Co-operative is not a magic structure, and it should not be applied to ventures that do not incorporate the strategies of two-way delivery contracts and high member equity investment. Producers must be willing to commit time to the development process, to invest sufficient equity to capitalize the project, and to contract product to supply the plant, or the project will not succeed. If producers are not committed through delivery contracts and investment, it will be difficult to leverage other investment funds, either as debt or outside investment capital. If the two-way contracts are replaced with softer delivery agreements, the risks to the co-operative increase because it will not have a secure supply of product.

Key Steps in the Issuance of Securities*

IAN MCINTOSH**

Definition

A security is defined under *The New Generation Co-operatives Act* (hereinafter the *NGC Act*) as including a preferred share, a debt obligation of a co-operative, and a certificate evidencing that share or debt obligation, and, for the purposes of Parts XVI, XIX, and XXII, includes a common share and member loan.

Why Do NGCs Issue Securities?

NGCs will need to assemble sufficient financing to develop and initiate the operation of their businesses. It is unlikely that the total capital required could be borrowed from financial institutions; therefore, the co-operative must seek investment from its members, and possibly the public. Capital raised in this manner involves the issuing of securities. These securities can be in the form of:

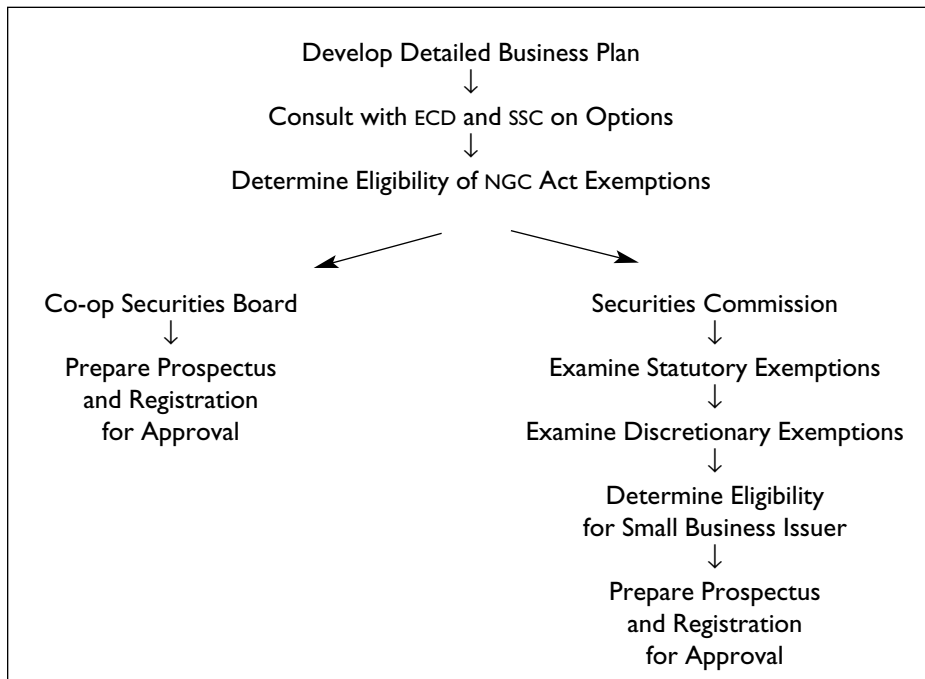
- *Common shares*, which may be sold only to members;
- *Preferred Shares*, which include the following two types:

* This paper does not constitute a legal opinion. Readers are advised to seek professional legal advice before proceeding.

** With acknowledgement to previous materials prepared by staff of Economic and Co-operative Development.

- *Member Right Shares*, which may only be sold to members, which carry no vote on election of a director, and which obligate its holder to provide the co-operative a specific good or service or give the holder the right to receive from the co-operative a specific good or service; and
- *Preferred Shares in a Series*, which may be sold to members and the general public, and may include specified rights and restrictions;
- *Member Loans*, including any agreement by which a member agrees to loan money to the co-operative; and
- *Other Debt Instruments*, including bonds and debentures issued to members or the general public by which the co-operative agrees to repay, with or without interest.

Part XXII—Security Issues of the *NGC Act*, together with the Regulations, set out the rules governing how an NGC can issue securities:



Develop a Business Plan

Complete a business plan, including details of sources of financing and a detailed explanation of the business operations. For larger offerings, conduct a feasibility study.

Consultations

The author encourages advance consultation between issuers and their professional advisors to discuss any proposals, and for assistance in determining whether the securities qualify for existing exemptions or if a prospectus may be required. Please contact the Deputy Director, Corporate Finance, at (306) 787-5867.

Steps to Obtain Approval to Issue Securities

Approval to Issue Securities

Unless the security is exempt under the *NGC Act* or Regulations, the co-operative must apply to the Co-operative Securities Board (the Board) regarding the issuance of securities. (The Board has the legislated responsibility for reviewing and approving the securities offerings of co-operatives and setting such terms and conditions on the approval as it sees necessary.) A co-operative also has the option under the *NGC Act* to advise the Board by written notice that all trades by the co-operative in a proposed offering of the securities specified in the notice will comply with *The Securities Act, 1988* (hereinafter referred to as the *Securities Act*). This option is an important change from how securities offerings are dealt with under *The Co-operatives Act, 1996*.

As a first step, a co-operative should determine if the proposed issue of securities is exempt from any review under the *New Generation Co-operatives Act*.

New Generation Co-op Act/Regulation Exemptions

Examine the possibility of whether the offering of the securities could be exempt under the *NGC Act* or Regulations. Exemptions include:

- A. bonds, debentures, or other indebtedness of or guarantees by a trust corporation or a loan corporation licensed pursuant to *The Trust and Loans Corporations Act* or an insurance company licensed pursuant to *The Saskatchewan Insurance Act*;
- B. certificates or receipts of a trust corporation or a loan corporation licensed pursuant to *The Trust and Loans Corporations Act*;
- C. bonds, debentures, or other indebtedness guaranteed by the government of Canada or of any province or territory of Canada;
- D. any securities where the purchase is a requirement of membership in the New Generation Co-operative as set out in the by-laws and the total value of those securities purchased by the member does not exceed \$1,000;
- E. securities sold to a trust or loan corporation, an insurance corporation, a credit union, or a bank;
- F. prepaid accounts where a member pays for goods and services in advance of delivery;
- G. shares issues in payment of a dividend, or interest payment on shares, or a patronage dividend;
- H. securities sold only to members of the co-operative, where all the members are also directors of the co-operative;
- I. securities sold only to members of the co-operative where:
 - i. the proceeds are used to purchase assets that are used solely by or for members, and
 - ii. the cumulative amount raised using this exemption does not exceed \$100,000;
- J. securities sold only to members of the co-operative where:

- i. the proceeds are used to pay any of the following costs:
 - a. costs related to the preparation of feasibility studies, business plans, and other similar documents, and
 - b. costs related to the preparation of any materials used or costs incurred in relation to an offering of securities by the co-operative; and
- ii. the cumulative amount raised using this exemption does not exceed \$100,000.

If the co-operative is unable to make use of these exemptions,
it should look to the exemptions available under *The Securities Act*.

As previously indicated, the co-operative has the option to have its trades done in compliance with the *Securities Act* if it wishes.

Saskatchewan Securities Commission

The Securities Act, 1988—Statutory Exemptions

If the co-operative determines that a statutory registration and prospectus exemption under the *Securities Act* could be applicable to the proposed offering of securities, the co-operative can elect, by written notice to the Board, to have all trades in the proposed offering specified in the notice comply with the *Securities Act*. These exemptions are included in detail in the “How To Raise Capital Using Exemptions” paper prepared by the Securities Commission. To receive a copy of this paper, contact the Saskatchewan Securities Commission at (306) 787-5299; alternatively, the information is available on the Saskatchewan Securities Commission web site at: www.ssc.gov.sk.ca.

Discretionary Exemptions

If the issuance of the securities does not fit within the statutory exemption from the registration and prospectus requirements of the *Securities Act*, then the co-operative can apply to the Commission under

Section 83 of the *Act* for a discretionary exemption waiving the registration and prospectus requirements of the *Securities Act*. The Commission has the power to grant a discretionary exemption from both the prospectus and registration requirements of the *Act* under this section. To apply for a discretionary exemption, the co-operative must follow the procedure set out in Saskatchewan Policy Statement 12-601, “Applications to the Saskatchewan Securities Commission.” To receive a copy, contact the Saskatchewan Securities Commission at (306) 787-5299; alternatively, the information is available on the Saskatchewan Securities Commission web site at: www.ssc.gov.sk.ca.

It is possible to apply to the Board for a discretionary exemption under *The New Generation Co-operatives Act*. As guidance in preparing the application, the New Generation Co-operative should follow the procedures set out in Saskatchewan Policy Statement 12-601. The application should be sent to the attention of the Secretary to the Board, c/o The Saskatchewan Securities Commission.

Before granting a discretionary exemption under Section 83 of the *Securities Act*, the Commission must first be satisfied that it is not prejudicial to the public interest to do so. There is no guarantee that the Commission will grant a discretionary exemption when applied for. The Commission will consider whether there are other factors in place for public protection, making prospectus and registration requirements of the *Securities Act* unnecessary.

Discretionary exemptions are often granted where a trade almost meets the requirements of a statutory exemption and the policy considerations behind that statutory exemption are met, but, because of a technicality, the trade does not fall within the statutory exemption.

The Commission may grant a discretionary exemption in cases where there is a special relationship between the NGC and the investors, and, through this special relationship, the investors have a special knowledge both about the NGC and its promoters. In this case, the investors may not require the protection afforded by registration or the disclosure normally made in a prospectus.

Discretionary exemptions may be granted in cases where the Commission is satisfied investors are knowledgeable, sophisticated, can protect themselves, and don't require the protection of the *Securities Act*.

In general terms, the Commission is open minded as to when it will grant a discretionary exemption. It must be satisfied that the results will be that the same level of public protection is provided, albeit in a different manner, as would be present if the registration and prospectus requirements of the *Securities Act* had been complied with. Discretionary exemptions usually have terms and conditions attached to them, and may, or may not, require the use of an offering memorandum.

The sale of securities by an NGC pursuant to a discretionary exemption does not in and of itself trigger any Continuous Disclosure Requirements or Resale Restrictions unless such requirements are built into the terms and conditions of the discretionary exemption received from the Commission. Therefore, an NGC will only become subject to those restrictions that are imposed as a term of the discretionary exemption. An issuer should look to the terms of the discretionary exemptions for its requirements in this regard. It is usual for the Commission to build in these types of requirements. This is the same with respect to the report of sales that must be filed with the Commission after the use of the discretionary exemption, the terms of which must be reviewed to find the NGC's requirements in each instance.

The most common discretionary exemption under Section 83 that could be used for an NGC would be the Community Ventures Exemption.

Community Ventures Exemption

This policy statement allows the NGC to apply for and the Commission to exempt the NGC from the registration and prospectus requirements of the *Securities Act*. The conditions that apply under the Community Ventures Exemption are as follows:

- a. the project must be located in a small community;
- b. the co-operative cannot raise more than \$1 million;
- c. the investors must live within a certain geographic area of the small community;

- d. all salespersons and promoters must live within the small community;
- e. there is no limit on the number of investors; and
- f. an offering memorandum must be approved by the Commission.

For complete information on this exemption, refer to the Community Ventures Information Package available by contacting the Saskatchewan Securities Commission at (306) 787-5299. For information about the use of exemptions, call (306) 787-5879 (Legal Branch).

Should the New Generation Co-operative find that there are no statutory or discretionary exemptions available for its proposed security offering, then it is probable that a prospectus will be required.

Prospectus Distributions

A prospectus is a legal document by which securities are offered for sale. The prospectus must contain full, true, and plain disclosure of all material facts relating to the securities issued. It provides prospective investors with sufficient information to enable them to make an informed decision about whether or not to purchase any of the securities offered. The Securities Regulations establish the details as to the form and content of the prospectus.

If this is the avenue taken, the co-operative again has a choice to make: whether the offering will be subject to the *NGC Act*, or whether an election will be made to have the offering reviewed and subject to the *Securities Act*. In either case, the co-operative needs to do a fair bit of work in advance of preparing and filing a prospectus. This work would include a detailed business plan and a feasibility study.

The Disclosure Document

The information disclosure requirements for a prospectus filed under the *NGC Act* and the *Securities Act* are essentially identical. The form to be followed in preparing a prospectus for a New Generation Co-operative is the same in either case, Form 13—Information Required in Prospectus of

Industrial Company. This form is found in The Securities Regulations. The Board has directed that this form is to be followed if the prospectus is filed under the *NGC Act*, and subject to review and approval by the Board. This same form is compulsory if the New Generation Co-operative elects to have the distribution subject to the *Securities Act*.

The Review Process

The review process for prospectus filings is the same under the *Securities Act* and under the *NGC Act*. The materials are to be filed with the Deputy Director, Corporate Finance, with the Commission. The Deputy Director also serves as Secretary to the Co-operative Securities Board. The prospectus and any supporting materials will be reviewed in detail by the staff of the Commission. A letter requesting changes or additional detail will normally be provided within ten working days of receiving the prospectus. Thereafter, it will be up to the New Generation Co-operative to resolve the comments. A revised prospectus incorporating the changes will then be required for further detailed review. Additional comments may be raised once more, with a further draft filed for review. This review process can take from six to eight weeks.

Once Commission staff are satisfied with the disclosure, and the selling process, as outlined below, has been appropriately addressed, approval to sell the securities will be given by one of two means. If the filing was made under the *Securities Act*, the Deputy Director, Corporate Finance, will issue a final receipt for the prospectus and selling may then proceed. If the filing has been made under the *NGC Act*, the deputy director will provide a copy of the final prospectus along with a recommendation to the Board. Conditions of approval may also be provided to the Board. If the Board is in agreement with the recommendations, they will approve the prospectus, and sales may commence.

For further information on the prospectus processes, contact the Deputy Director, Corporate Finance, at (306) 787-5867.

Registration and the Selling Process

A major consideration for a New Generation Co-operative will be the manner in which it contemplates the selling of the securities offered by prospectus. Under the *Securities Act*, the securities must be sold by a registrant company. Further, individuals selling the securities must also be registrants.

Frequently, smaller issuers are unable to make arrangements with a registrant to sell the securities offered by their prospectus. To assist these smaller issuers, the Commission has approved General Ruling/Order (GRO) 31-902—Saskatchewan Small Business Security Issuer. This GRO relaxes the normal registration requirements and allows the issuer to register as a security issuer; in other words, it will be offering its own securities for sale. The individuals designated by the issuer to sell the securities on its behalf will be required to take a one-day sales course provided by the staff of the Commission, and then must write and pass an examination, taken the same day as the course. This course provides basic information on the dos and don'ts of selling securities. Additional detail on this GRO follows.

The Board has indicated, in meetings held to discuss New Generation Co-operatives, that the selling issue is also of concern to them. They have indicated that they, too, will have concerns with how the securities may be sold, and it is likely that they will require the New Generation Co-operative and its sales force to follow the same requirements as set out in GRO 31-902.

To date, there are no precedents in this area.

Ongoing Continuous Disclosure Requirements

Once a New Generation Co-operative has raised money by prospectus, it will be required to communicate with its security holders on a regular basis. If the offering has been done under the *Securities Act*, the ongoing reporting requirements are statutory, and would include providing

interim quarterly financial statements and annual audited financial statements, as well as annual proxy and information circular materials.

If the offering has been done under the *NGC Act*, co-operatives should anticipate that the Board will make similar reporting mandatory as a condition of approval for the offering. Again, at this time there are no precedents to which we can refer for additional guidance.

Multijurisdictional Issues

It is possible that a New Generation Co-operative will wish to raise capital in more than one province, for a variety of reasons. In these scenarios, it is important that careful consideration be given as to which legislation the offering will be filed under in Saskatchewan. If the same prospectus is to be filed in other provinces, it will be reviewed under securities legislation in those provinces. There are co-ordinated mutual reliance review systems for reviewing offerings filed in more than one province, provided that the offering is filed under securities legislation in all provinces. This type of co-ordinated review is not possible if it is filed in Saskatchewan under the *NGC Act*, but filed elsewhere under the securities legislation of the other provinces. This will create a significant problem for the review of the securities filing. We encourage discussion of this issue with the officers of the New Generation Co-operative well in advance of filing a prospectus. Contact the Deputy Director, Corporate Finance, at (306) 787-5867.

General Ruling/Order 31—902 Saskatchewan Small Business Securities Issuer

If your NGC does not fit the criteria for the exemptions above, this general ruling/order can be used to relax the registration requirements of the *Securities Act* where the directors, officers, or others will be selling the securities, and the NGC meets the following criteria:

- a. is incorporated, continued, organized, or established pursuant to the laws of the Province of Saskatchewan;
- b. has its registered office and head office located in Saskatchewan;

- c. carries on a substantial part of its businesses in Saskatchewan, in that 75 percent of its business assets are or will be located in the province, and 75 percent of its expenses will be incurred there;
- d. is controlled by residents of Saskatchewan, in that 75 percent of its voting securities are held by them; and
- e. two-thirds of its promoters and directors are residents of Saskatchewan.

While this General Ruling/Order relaxes the registration requirements for the NGC, it would still require the use of a prospectus to issue the securities. For complete information on this exemption, refer to the Saskatchewan Small Business Securities Issuer Package that is available by contacting the Saskatchewan Securities Commission at (306) 787-5876 (Registration Branch) and on the Saskatchewan Securities Commission's web site at www.ssc.gov.sk.ca

The Secondary Trade*

DEAN MURRISON

Introduction

This section builds on the previous chapter titled “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 (such as an exchange such as the Canadian Ventures Exchange (CDNX)) or not organized (such as sales directly between individual holders of the securities of the NGC), those sales are referred to as being made in the *secondary market*.

* 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 the *NGC 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 *NGC 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 *NGC 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 *NGC 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 as 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 pur-

chaser 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 *NGC 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 or by calling the SSC at (306) 787-5299.

The *New Generation Co-operatives Act* works differently from the *Securities Act*. The *NGC 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 *NGC 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 *NGC 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 *NGC 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 *NGC 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 a 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 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 such as 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 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 *NGC 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 the 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 such as 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 *NGC 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 *NGC 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.

