

Liquidity Options In Canada For Private US Companies

September 2009

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CASSELS BROCK
LAWYERS



WHY CONSIDER CANADA?

Receptive to Smaller Issuers

Institutional and retail investors receptive to small and medium sized public issuers; many analysts cover small and medium sized public issuers providing greater visibility

Attractive Valuations

High demand for dividend paying equities from retail investors after income trust market curtailed; greater visibility and understanding of small and medium sized public issuers

Diverse Listings Base on TSX

Preeminent exchange for mining issuers; most oil & gas issuers of any global exchange; growing technology and cleantech sectors; investor demand for dividend-paying issues in all sectors; all stages of growth represented

Ease of Access to Capital

Bought deal financings make accessing capital relatively easy and fast, with much of the risk assumed by underwriters

TSX is World Class Exchange

One of world's largest exchanges; TSX Group lists more issuers than any other North American Exchange; superior market performance; a top exchange for raising equity capital

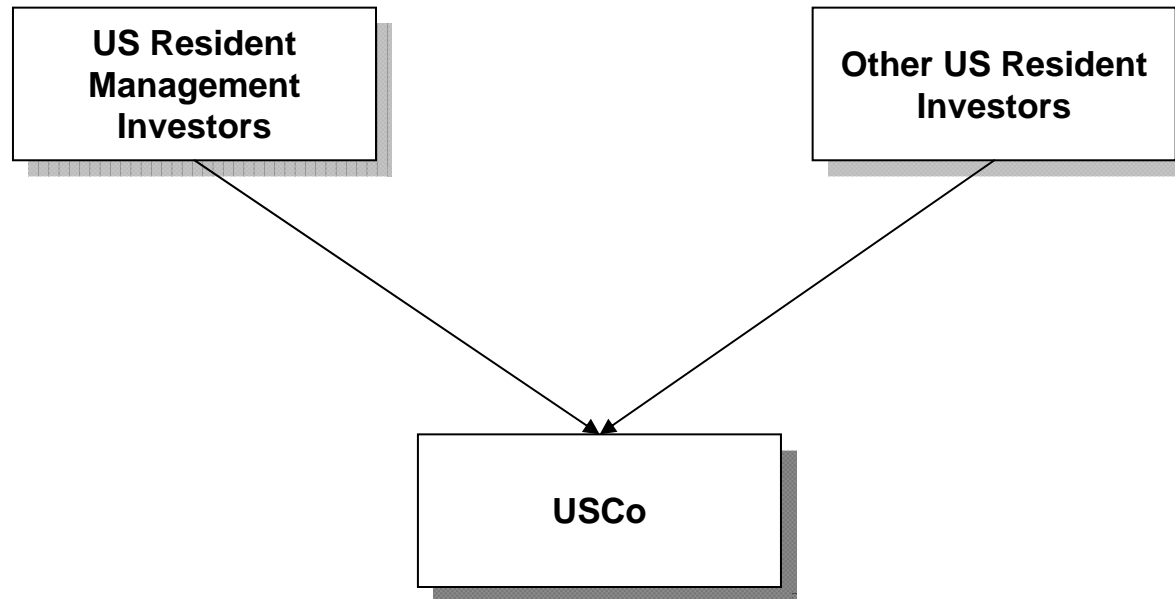
Speed of Execution

IPOs and other going public transactions in Canada can be completed significantly more quickly than in the United States

Regulatory Benefits

Canadian regulatory environment generally subject to fewer rules and has a lower cost of compliance; regulators are less intrusive; Sarbanes-Oxley does not apply to companies public only in Canada; no need to file registration statement in the United States to provide free-trading securities (if Canadian company); process in US is longer, more expensive and more restrictive manner to go public

TYPICAL EXISTING STRUCTURE



- Public market transaction typically contemplated where one or more of the following applies:
 - Additional capital is needed by USCo and private sources are not available on appropriate terms
 - Investors looking to monetize only a portion of their holdings
 - Public equity desired for acquisitions and management incentives
- Ownership interests often involve more than common shares of USCo

METHODS OF GOING PUBLIC IN CANADA

IPO by Redomiciled Parent (inversion)

- US domiciled company exports itself into a Canadian jurisdiction
- US shareholders of USCo become shareholders of Canadian company, but with combination of voting and non-voting securities
- Canadian company files and clears prospectus in Canada for a treasury offering of shares
- Canadian company is foreign private issuer
- Canadian company is inverted company, making it a US taxpayer
- No exchange of securities

IPO by New Canadian Parent (inversion)

- Canadian company files and clears prospectus in Canada for a treasury offering of shares
- USCo is acquired, in whole or in part, by Canadian company with cash raised from Canadian IPO and/or with shares of Canadian company
- US shareholders of USCo become shareholders of Canadian company (or have rights to exchange up)
- Canadian company is inverted company, making it a US taxpayer; US shareholders obtain tax deferral on exchange of shares

IPO by New Canadian Parent (no inversion)

- Canadian company files and clears prospectus in Canada for a treasury offering of shares
- USCo is acquired, in whole or in part, by Canadian company with cash raised from Canadian IPO
- US shareholders of USCo remain shareholders of USCo and are provided with certain rights to negotiate a repurchase by USCo of their shares for cash
- Canadian company is not a US taxpayer

METHODS OF GOING PUBLIC IN CANADA

RTO by New Canadian Parent/CPC Transaction

- USCo merges with US subsidiary of Canadian listed shell company, which could be a “capital pool company” (CPC) that is required to make an acquisition (similar to a SPAC)
- Can be accompanied by a financing
- Can be structured either with or without a resulting inversion for tax purposes
- CPC:
 - No need for shell shareholder approval of the acquisition
 - Additional regulatory review of transaction
 - Restrictions on cash raised by the CPC and on timing to complete; penalties if timing constraints not met
- RTO:
 - Requires shareholder approval
 - Limited number of available shells

IPO of USCo

- USCo company files and clears prospectus in Canada and a registration statement in the United States (in order to ensure that shares of USCo are free-trading)
- US shareholders of USCo remain shareholders of USCo to the extent they do not sell
- No exchange of securities that could trigger taxes for USCo shareholders
- USCo can be:
 - Registered with the SEC, but subject to Sarbanes-Oxley
 - Not SEC registered, but subject to mandatory SEC registration at certain thresholds
 - Restricted securities trade in a special terms market to avoid sales back into the United States, which reduces liquidity and attractiveness to investors and institutions

STRUCTURE CONSIDERATIONS

Structure will depend on a number of considerations, including those below:

US Tax Inversion

Inversions can be adverse events for the Canadian company and its shareholders, but may provide tax benefits to existing US shareholders; extent of retained interest, whether the entity intends to pay dividends and whether Canadian company would be a US real property holding corporation are key issues

Tax Position of USCo Shareholders

Ability of USCo shareholders to fund tax payments on any sales of shares to Canadian company and extent of gain will be important

Accounting

Shares of USCo purchased by Canadian company will receive consolidation in its financial statements only if more than 50% of USCo is purchased

Financing Method

The relative benefits of an initial private equity financing versus a public equity financing in the context of the issuer and the market

Sarbanes-Oxley

The compliance costs of being a full SEC registrant versus being a foreign private issuer

Type of Issuer/ Marketing

Issuers with sustainable free cash flows may be marketed differently than other issuers

Mining Issuers

Difficult to list on TSX if Canadian company's interest in mining properties is less than 50%

Rights for USCo Shareholders

USCo shareholders can be made shareholders of Canadian company or retain interest in USCo; retained interest can have exchange rights into public company or "negotiation" rights to negotiate a re-purchase

FUNDAMENTAL DECISIONS

**Is it desirable to have an inversion for US tax purposes
to benefit US shareholders?**

IMPACTS CHOICE OF STRUCTURE

**Should the public company be a
foreign private issuer?**

US TAX INVERSIONS

Adverse Effects of an Inversion

- If the inversion rules are met and former shareholders of USCo are treated as owning 80% or more of the public company then such Canadian public company would be treated as a US corporation subject to tax in the US. The public company is also taxable in Canada. The public company could be subject to double taxation depending on the nature of its income, if any. US and Canadian shareholders will be subject to double taxation in respect of dividends. Transfers between operating US subsidiary and parent may create tax leakage.
- Depending on the nature of the assets, the public company could be a US real property holding corporation. If so, Canadian shareholders would likely be subject to: US federal income tax on gains realized on the sale of the public company shares, subject to the 5% exemption for shares of publicly held corporations that regularly trade; and withholding of US taxes on dividends paid to them.
- If the inversion rules are met and former USCo shareholders are treated as owning more than 60% but less than 80% of the public company, the ability to use USCo's net operating losses against certain gains realized on the sale of its assets during the 10-year period following the inversion transaction may be limited.

Beneficial Effects of an Inversion

- US shareholders can exchange into shares of the public company on a tax-deferred basis

How Does an Inversion Occur?

- In order for a transaction to be treated as an inversion, the following three conditions must be satisfied:
 1. a non-US corporation ("Canco") acquires, directly or indirectly (i.e., through acquiring stock), substantially all of the properties held, directly or indirectly, by a US corporation (e.g., USCo);
 2. following the acquisition, Canco, together with all members of Canco's "expanded affiliated group", does not conduct substantial business activities in the country in which Canco is organized (in this case Canada) —when compared to the total worldwide business activities of Canco; and
 3. following the acquisition, the former shareholders of USCo own at least 60%, by vote or value, of the stock of Canco (by reason of holding stock in USCo)
- When calculating the 60% fraction, shares issued in a public offering are excluded. For this purpose, any Canco shares issued for cash in a private placement related to the going public transaction would also be excluded.
- Any transaction that results in Canco shares becoming publicly traded and the former shareholders of USCo receiving shares in the public company could result in the application of the inversion rules.

The inversion issue is the reason for using negotiation rights in structures where the US shareholders retain an interest in the business

FOREIGN PRIVATE ISSUERS

Benefits of Being a Foreign Private Issuer

- If not an SEC registrant, not subject to Sarbanes-Oxley regulation and the attendant higher costs of compliance.
- Can conduct public offering in Canada without SEC registration.
- Can conduct private placement financings in the US without the need for later registration of such securities.
- Could still be listed in the United States, subject to registration under the US Exchange Act.
- Availability of special forms and exemptions for SEC reporting and registration.

What is a Foreign Private Issuer?

- The term foreign private issuer means any foreign issuer except an issuer meeting the following conditions:
 1. More than 50 % of the issuer's outstanding voting securities are directly or indirectly held of record by residents of the United States; and
 2. Any of the following:
 - i. The majority of the executive officers or directors are United States citizens or residents;
 - ii. More than 50 percent of the assets of the issuer are located in the United States; or
 - iii. The business of the issuer is administered principally in the United States.
- Foreign issuer means any issuer which is a foreign government, a national of any foreign country or a corporation or other organization incorporated or organized under the laws of any foreign country.

There is a bias in favour of foreign private issuer status as a result

METHODS OF GOING PUBLIC IN CANADA - ILLUSTRATED

IPO by Redomiciled Parent
(inversion)

IPO by New Canadian Parent
(inversion)

IPO by New Canadian Parent
(no inversion)

RTO by New Canadian Parent/Capital Pool Company
Transaction

IPO of USCo

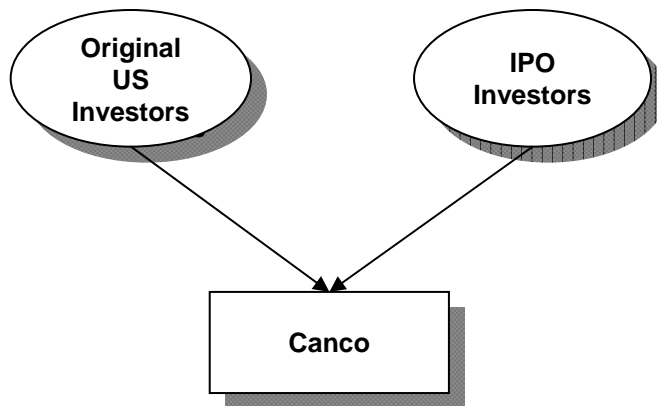
IPO BY REDOMICILED PARENT: TAX INVERSION

Steps

1. USCo company exports itself to Canadian jurisdiction
2. US Shareholders receive combination of voting and non-voting shares
3. Canadian company prepares, files and clears prospectus in Canada
4. US shareholders receive cash for any sales made in the IPO
5. Canadian company likely inverted for US tax purposes

Advantages

1. US shareholders can participate in IPO
2. US shareholders get immediate liquidity
3. US shareholders not necessarily subject to tax – transaction can be made taxable if desired
4. Public company owns 100% of operating business – no holding company discount
5. Retail distribution available
6. No US registration



Inversion: Yes

Foreign Private Issuer: Yes

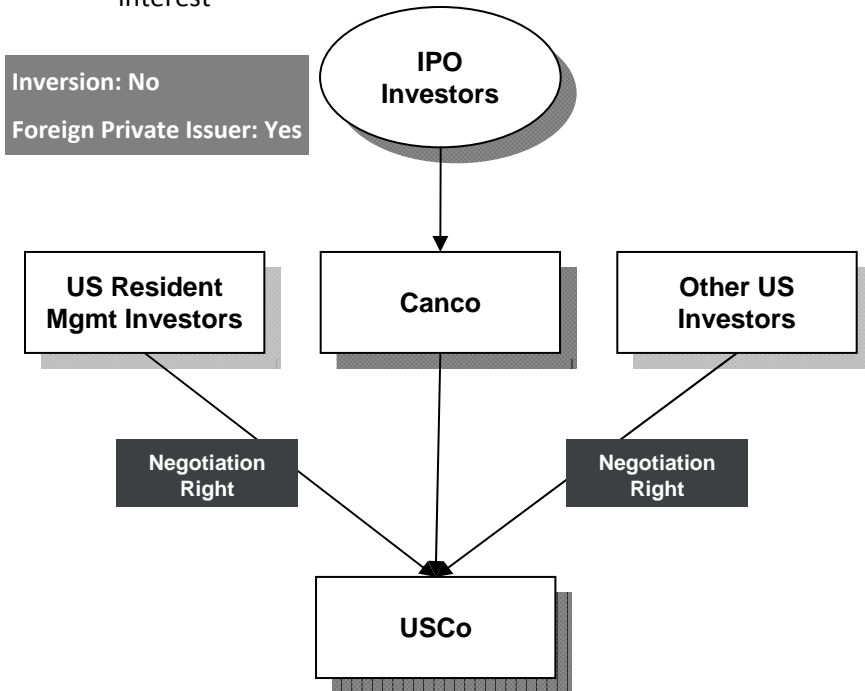
Disadvantages

1. One or more adverse tax inversion consequences, which could make an investment unattractive to investors
2. Cannot market USCo to investors until prospectus is receipted
3. Financing and US shareholder monetization is subject to IPO risk
4. US shareholders cannot hold more than 50% of the voting securities of the Canadian company
5. US shareholders may not be open to receiving non-voting securities

IPO BY NEW CANADIAN PARENT: NO TAX INVERSION

Steps

1. Canadian company incorporated
2. Canadian company prepares, files and clears prospectus in Canada (providing disclosure on USCo and the resulting structure)
3. IPO proceeds used to purchase interest in USCo either from US shareholders or from treasury
4. US shareholders get cash for their interest sold, but no shares in Canadian company
5. US shareholders get a *negotiation right* in respect of their retained interest



Advantages

1. US shareholders can participate in IPO
2. No tax inversion for Canadian company
3. No US registration
4. No negative tax consequences to US shareholders
5. Retail distribution available
6. No concern with meeting foreign private issuer test

Disadvantages

1. US shareholders do not get immediate liquidity in their retained interest
2. Management's retained interest not perfectly aligned with public shareholders
3. Uncertainty surrounding the operation of the negotiation right and the price that will be paid
4. Negotiation right is subject to the ability of USCo to pay
5. Financing and US shareholder monetization is subject to IPO risk
6. Possible discount as a result of holding less than 100% of operating business
7. May be accounting or Investment Company Act issues where less than 50% of USCo is held by Canadian company

Alternative – Establish Business in Canada

1. If business is at initial stages, founders organize Canadian company with a majority of voting stock held by non-US shareholders.
2. US operations held by company incorporated in Delaware and headquartered in US with US management.
3. No inversion; no minority interests in operating company.
4. Consider tax implications of IP, if any, transferred to Canadian company

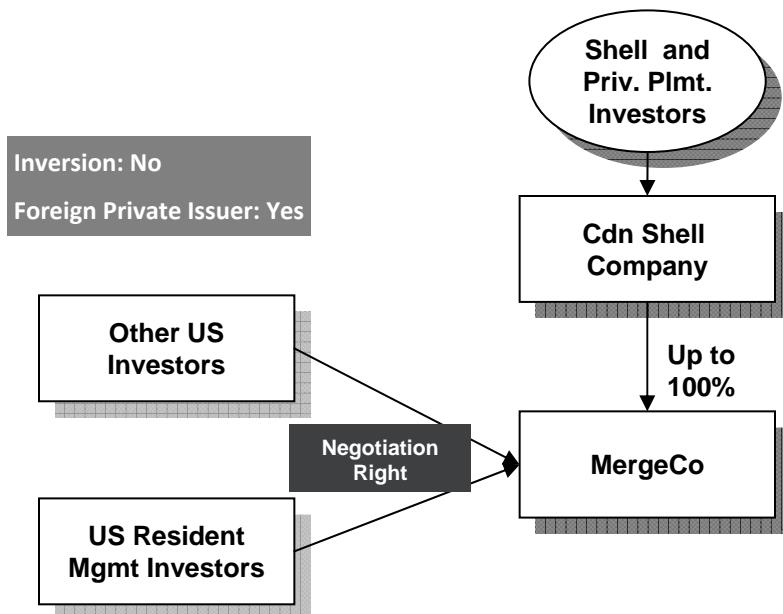
The **negotiation right** is a right of the US shareholders to cause USCo to negotiate in good faith with them for the re-purchase of their shares at fair market value; the price paid cannot be tied to the public company's shares; no assurance can be given that the shares will in fact be purchased or that the price will be acceptable; often limited number of opportunities to go through this process

Used in many US income trust IPOs in Canada

CPC QUALIFYING TRANSACTION/RTO BY NEW CANADIAN PARENT

Steps

1. Suitable shell company of CPC located in Canada
2. Shell company subsidiary undertakes private placement of subscription receipts in Canada
3. USCo and subsidiary of shell company agree to merge
4. Subscription receipts convert to shares of subsidiary immediately prior to merger, with USCo surviving the merger
5. Shell shareholders and private placees get shares of the new public company
6. Funds from private placement used to purchase interest of US shareholders and/or for the account of the business
7. US shareholders retain interest in US MergeCo, plus are issued a negotiation right



Advantages

1. Ability to raise majority of funds without accessing public market and issuing a disclosure document with related liability
2. Less subject to IPO risk
3. No inversion for Canadian company
4. No US registration needed
5. No negative tax consequences to US shareholders, except to extent negotiation rights have value
6. Potential for value bump for private placement investors

Disadvantages

1. US shareholders do not get immediate liquidity in their retained interest
2. Management's retained interest not perfectly aligned with public shareholders
3. Uncertainty surrounding the operation of the negotiation right and the price that will be paid
4. Negotiation right is subject to the ability of USCo to pay
5. Financing and US shareholder monetization are subject to IPO risk
6. Possible discount as a result of holding less than 100% of operating business
7. May be accounting or Investment Company Act issues where less than 50% of USCo is held by Canadian company

Alternative - Inversion

1. Structure can be used to effect an inversion also
2. Former shareholders of USCo exchange their shares for shares of the public company
3. Exchanging shareholders able to obtain roll-over treatment
4. Avoids minority discount, accounting issues and Investment Company Act issues
5. May require that US shareholders be issued non-voting securities to maintain foreign private issuer status

IPO BY USCO

Steps

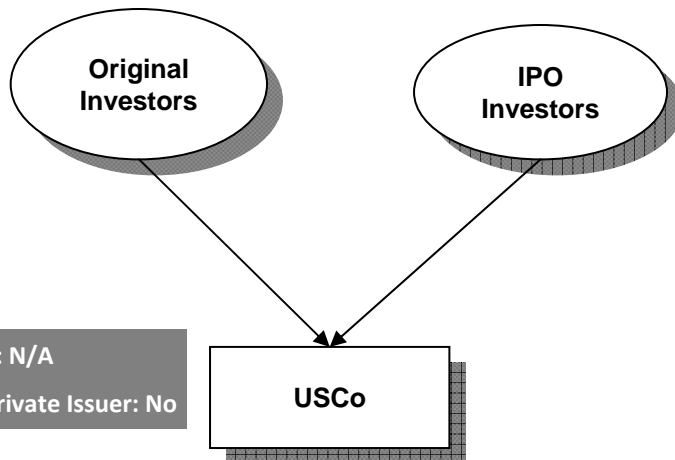
1. USCo prepares, files and clears prospectus in Canada and registration statement in the US
2. US shareholders sell shares to the public in a secondary offering and get cash for any shares sold
3. USCo sells shares in a treasury offering, with proceeds for the account of USCo

Advantages

1. US shareholders can participate directly in IPO
2. Simplest structure – no exchange by US shareholders; no negotiation rights
3. No minority interests in USCo
 - No discount
 - No accounting issues
4. No personal tax issues for US retained interest holders – no exchange of securities
5. Retail distribution available

Disadvantages

1. If USCo is not SEC registrant, its share issuances will be restricted securities requiring safeguards to prevent redistribution into US - can be complicated and reduce liquidity of shares
2. USCo may be forced to become SEC registrant when it reaches 500 shareholders of record
3. If USCo is full SEC registrant, it is subject to Sarbanes-Oxley and other US securities laws applicable to US issuers
4. Financing and US shareholder monetization are subject to IPO risk
5. Avoids inversion issues



Inversion: N/A
Foreign Private Issuer: No

METHODS OF GOING PUBLIC IN CANADA – STRUCTURE CHOICE

| | Suitability | Representative Issuers |
|---|--|--|
| IPO by Redomiciled Parent (inversion) | Companies that desire to become foreign private issuers or have a significant percentage of its voting securities held by non-US taxpayers. Companies with significant non-US assets, management and directors. Structuring these transactions may be complex and US shareholders may be adverse to receiving non-voting securities. | Fluid Music Canada Inc. ID Watchdog, Inc. (Cayman Islands) |
| IPO by New Canadian Parent (inversion) | Companies that desire to become foreign private issuers or have a significant percentage of its voting securities held by non-US taxpayers. Companies with significant non-US assets, management and directors. Structuring these transactions may be complex and US shareholders may be adverse to receiving non-voting securities. | Phoenix Coal Corp. |
| IPO by New Canadian Parent (no inversion) | Companies that desire to become foreign private issuers or have a significant percentage of its voting securities held by non-US taxpayers. Companies with significant non-US assets, management and directors. Structuring these transactions may be complex and US shareholders may be adverse to receiving non-voting securities. | AndeanGold Ltd. (established in Canada) Medical Facilities Corporation Northstar Healthcare Inc. Primary Energy Recycling Corporation Student Transportation of America Ltd. |
| RTO by New Canadian Parent/Capital Pool Company Transaction | Companies that are in early formation stages or entities or small groups that have assets (in or outside the United States) with relatively high tax basis. Companies who may not need any additional financing, but require distribution to satisfy exchange requirements. Companies who can accept reduced pricing to avoid market risk. Structuring these transactions may be complex and US shareholders may be adverse to receiving non-voting securities. | Acro Energy Technologies Corp. Axiotron Corp. PBS Coals Corporation |
| IPO of USCo | Companies with significant US operations that may have difficulties structuring as a foreign private issuer or qualifying for a tax-free rollover. Companies that cannot reincorporate outside of the US due to regulatory or contractual restrictions. US companies that contemplate a concurrent or near-term US listing may elect to use this structure. If no US registration, may have a negative effect on the public market for such securities. Issuers with large numbers of shareholders of record will need to monitor its shareholders of record. | Catch the Wind Ltd. (.s) US Gold Corporation World Energy Solutions |

FOR FURTHER INFORMATION



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